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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

No. 486

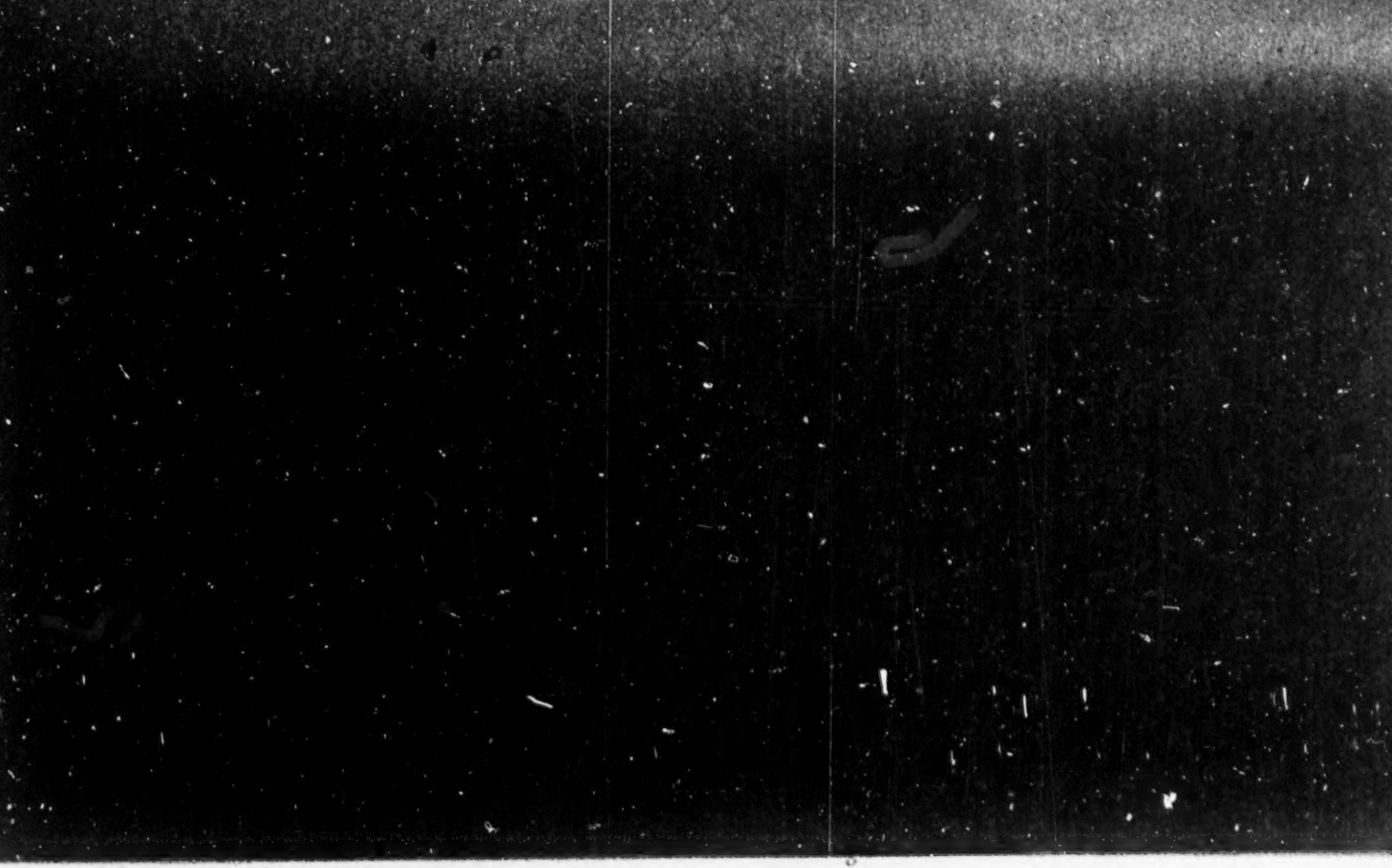
GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

METROPOLITAN EDISON COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI, FILED NOVEMBER 23, 1938
CERTIORARI GRANTED JANUARY 3, 1939



SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

No. 486

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

METROPOLITAN EDISON COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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1 Before United States Board of Tax Appeals

Docket No. 57869

METROPOLITAN EDISON COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Petitioner: Francis J. Sweeney, Esq.; for Respondent: C. A. Gwinn, Esq.

(Transferred to Mr. Black 10/23/36.)

Docket entries

May 4, 1931—Petition received and filed. Taxpayer notified. (Fee paid.)
May 5, 1931—Copy of petition served on General Counsel.
June 10, 1931—Answer filed by General Counsel.
June 23, 1931—Copy of answer served on taxpayer—General Calendar.
Jan. 31, 1933—Hearing set 3/6/33.
Feb. 14, 1933—Motion for continuance to the Fall Calendar filed by taxpayer. 2/16/33 granted to 6/6/33.
May 20, 1933—Motion for continuance to Fall Calendar filed by taxpayer. 5/22/33 granted.
2 Aug. 25, 1934—Hearing set Oct. 22, 1934.
Oct. 22, 1934—Hearing had before Mr. Smith, Division 5, on merits. Stipulation of facts and exhibits filed. Supplemental stipulation to be filed on 12/22/34. Petitioner's brief due Dec. 22, 1934, Commissioner's brief Jan. 22, 1935, petitioner's reply brief Feb. 6, 1935.
Oct. 31, 1934—Transcript of hearing Oct. 22, 1934, filed.
Dec. 7, 1934—Supplemental stipulation of facts filed.
Dec. 20, 1934—Brief filed by taxpayer. 12/20/34 brief served on General Counsel.
Jan. 18, 1935—Motion for extension to 2/2/35 to file brief filed by General Counsel. 1/21/35 granted—petitioner's reply due 2/18/35.
Feb. 2, 1935—Brief filed by General Counsel.
Feb. 16, 1935—Reply brief filed by taxpayer. 2/16/35 copy served.
May 14, 1937—Findings of fact and opinion rendered—Mr. Black, Division 15. Decision will be entered under Rule 50.
June 16, 1937—Motion for order of redetermination filed by General Counsel.
June 17, 1937 —Hearing set July 7, 1937, on settlement.
June 30, 1937—Motion for order of redetermination filed by taxpayer 7/1/37 copy served.

3 June 30, 1937—Motion to substitute the attached amended recomputation in lieu of the recomputation submitted on June 16, 1937, filed by General Counsel. 7/2/37 granted.
July 2, 1937—Decision entered—Mr. Black, Division 15.
Sept. 17, 1937—Motion to fix amount of bond filed by taxpayer. 9/17/37 bond ordered fixed at $168,000.00.
Sept. 29, 1937—Supersedeas bond in the amount of $168,000.00 approved and ordered filed.
Sept. 29, 1937—Petition for review by U. S. Circuit Court of Appeals, 3rd Circuit, with assignments of error filed by taxpayer.
Sept. 29, 1937—Proof of service filed by taxpayer.
Sept. 29, 1937—Praecipe with proof of service thereon filed.

4 Before United States Board of Tax Appeals

Docket No. 57869

METROPOLITAN EDISON COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition

Filed May 4, 1931

Metropolitan Edison Company hereby petitions for a redetermination of an asserted deficiency and alleges as follows:

I. The Commissioner of Internal Revenue, the respondent herein, by letter dated March 11, 1931, and bearing the bureau reference or symbols IT:AR:B-8-TMM-60D notified your petitioner by registered mail, of deficiency in income taxes with respect to the income tax imposed by the Revenue Acts of 1926 and 1928.

II. Your petitioner was, at all times hereinafter mentioned, a corporation duly organized and existing under the laws of the State of Pennsylvania and was engaged in the business of generation and sale of electrical energy.

III. Upon information and belief the notice of deficiency, a copy of which is attached hereto, made a part hereof as though here set forth in full and marked Exhibit A, was mailed to your petitioner on March 11, 1931.

IV. The taxes in controversy are as follows:

For the fiscal period beginning January 1, 1927, and ending
5 December 31, 1927, $249,422.80, and for the fiscal period beginning January 1, 1928, and ending December 31, 1928, $407,285.21.

V. The respondent's determination of income taxes set forth in said deficiency letter is based upon the following errors:

A. That the respondent erroneously and illegally increased your petitioner's taxable net income for the aforesaid fiscal periods by adding to or failing to deduct from the taxable net incomes of its affiliated taxpayers, the following items:

Item	Name of affiliated taxpayer	Year and description of item		
1	Hanover & McSherrystown Street Railway Company	1927	Depreciation	$8,264.11
2	Pennsylvania Edison Company	1927	Loss on property retired	92,517.85
3	Pennsylvania Edison Company	1927	Fire loss Bangor Plant	101,800.61
4	Pennsylvania Edison Company	1927	Depreciation	294,732.75
5	Maryland Public Service Co	1927	Depreciation	350.00
6	Saylorsburg Light & Power Co	1927	Depreciation	818.24
7	Easton Gas Works	1927	Depreciation	12,134.64
8	Easton Gas Works	1927	Loss on property retired	9,119.34
9	Interurban Gas Company	1927	Depreciation	1,009.02
10	Metropolitan Power Company	1927	Depreciation	13,452.76
11	The Pen Argyl Gas Company	1927	Depreciation	1,010.77
12	Easton Gas Works	1928	Depreciation	9,280.20
13	Interurban Gas Company	1928	Depreciation	972.93
14	Hanover & McSherrystown Street Railway Company	1928	Depreciation	4,127.47
15	The Maryland Public Service Company	1928	Depreciation	57.69
16	Hamburg Gas & Electric Co	1928	Depreciation	2,807.45
17	Topton Electric Light & Power Company	1928	Depreciation	854.38
18	Weisenberg Township Electric Light & Power Company	1928	Depreciation	174.66
19	Birdsboro Electric Company	1928	Depreciation	375.82
20	Boyertown Electric Company	1928	Depreciation	2,227.85
21	Annville & Palmyra Electric Light Company	1928	Depreciation	1,585.22
22	Bernville Light, Heat & Power Company	1928	Depreciation	360.55
23	Berks-Lehigh Electric Company	1928	Depreciation	541.11
24	Blue Mountain Electric Company	1928	Depreciation	2,371.30
25	Pennsylvania Edison Company	1928	Depreciation	54,640.61
26	Pennsylvania Edison Company	Loss on property retired—1928		1,347.29

6 B. That the respondent erroneously and illegally increased your petitioner's taxable net income for the aforesaid fiscal period by adding thereto or failing to deduct therefrom as follows:

	Year	Amount
1. Amortization	1927	$551,742.90
2. Loss on property retired	1927	230,728.32
3. Depreciation	1927	530,895.01
4. Depreciation	1928	814,176.18
5. Amortization	1928	2,455,855.85
6. Loss on property retired	1928	75,338.80

C. That the respondent has erroneously and illegally annulled, modified, set aside and/or disregarded a final agreement between the respondent and your petitioner and its affiliated taxpayers fixing the amount of Federal income tax liability of your petitioner and/or its affiliated taxpayers for the calendar year 1927 and/or parts thereof and that the determination of the respondent contained in Exhibit A is without authority and contrary to the law and regulations made and provided.

D. That the respondent erroneously and illegally annulled, modified, set aside, and/or disregarded a final agreement between the respondent and your petitioner and its affiliated taxpayers for the calendar year 1928 and/or parts thereof and that the determination of

the respondent contained in Exhibit "A" is without authority and contrary to the law and regulations made and provided.

E. That the respondent erroneously and illegally increased your petitioner's income tax liability for the calendar year 1928 by failing to allow credit to your petitioner and/or its affiliated taxpayers for income taxes assessed and paid for said period in the amount of $370.33.

VI. Facts upon which your petitioner relies as sustaining the aforesaid assignments of error are as follows:

A. Affiliated taxpayers—Facts as to erroneous and illegal increases in taxable net incomes of affiliated taxpayers by the respondent:

1. Hanover & McSherrystown Street Railway Company—That the depreciable assets of said Hanover & McSherrystown Street Railway Company for the calendar year 1927 was a sum certain, sufficient to constitute the amount of $8,264.11 as a fair and reasonable allowance for depreciation.

2. Pennsylvania Edison Company—That during the calendar year 1927 said Pennsylvania Edison Company sold miscellaneous capital assets and sustained a loss of $92,517.85 on said sale. The respondent failed to allow said loss as a deduction from income in determining taxable net income for the calendar year 1927.

3. Pennsylvania Edison Company—That during the calendar year 1927 said Pennsylvania Edison Company sustained a loss of $101,800.61 by reason of a fire at its Bangor power plant. The respondent failed to allow said loss as a deduction from income in determining taxable net income for 1927.

4. Pennsylvania Edison Company—That the depreciable assets of said Pennsylvania Edison Company for the calendar year 1927 was a sum certain, sufficient to constitute the amount of $294,732.75 as a fair and reasonable additional allowance for depreciation.

5. Maryland Public Service Company—That the depreciable assets of said Maryland Public Service Company for the calendar year 1927 was a sum certain, sufficient to constitute the amount of $350.00 as a fair and reasonable allowance for depreciation.

6. Saylorsburg Light & Power Company—That the depreciable assets of said Saylorsburg Light & Power Company for the period beginning August 1, 1927, and ending November 30, 1927, was a sum certain, sufficient to constitute the amount of $818.24 as a fair and reasonable allowance for depreciation.

7. Easton Gas Works—That the depreciable assets of said Easton Gas Works for the calendar year 1927 was a sum certain, sufficient to constitute the amount of $12,134.64 as a fair and reasonable additional allowance for depreciation.

8. Easton Gas Works—That during the calendar year 1927 said Easton Gas Works sold miscellaneous capital assets and sustained a loss of $9,119.34 on said sale. The respondent failed to allow said

loss as a deduction from income in determining taxable net income for the calendar year 1927.

9. Interurban Gas Company—That the depreciable assets of said Interurban Gas Company for the calendar year 1927 was a sum
9 certain, sufficient to constitute the amount of $1,009.02 as a fair and reasonable allowance for depreciation.

10. Metropolitan Power Company—That the depreciable assets of said Metropolitan Power Company for the period beginning January 1, 1927, and ending March 31, 1927, was a sum certain, sufficient to constitute the amount of $13,452.76 as a fair and reasonable additional allowance for depreciation.

11. The Pen Argyl Gas Company—That the depreciable assets of said The Pen Argyl Gas Company for the period beginning August 1, 1927, and ending November 30, 1927, was a sum certain, sufficient to constitute the amount of $1,010.77 as a fair and reasonable allowance for depreciation.

12. Easton Gas Works—That the depreciable assets of said Easton Gas Works for the calendar year 1928 was a sum certain, sufficient to constitute the amount of $9,280.20 as a fair and reasonable additional allowance for depreciation.

13. Interurban Gas Company—That the depreciable assets of said Interurban Gas Company for the calendar year 1928 was a sum certain, sufficient to constitute the amount of $972.93 as a fair and reasonable additional allowance for depreciation.

14. Hanover & McSherrystown Street Railway Company—That the depreciable assets of said Hanover & McSherrystown Street Railway Company for the calendar year 1928 was a sum certain,
10 sufficient to constitute the amount of $4,127.47 as a fair and reasonable additional allowance for depreciation.

15. The Maryland Public Service Company—That the depreciable assets of said The Maryland Public Service Company for the calendar year 1928 was a sum certain, sufficient to constitute the amount of $57.69 as a fair and reasonable additional allowance for depreciation.

16. Hamburg Gas and Electric Company—That the depreciable assets of said Hamburg Gas and Electric Company for the period beginning April 1, 1928, and ending July 1, 1928, was a sum certain, sufficient to constitute the amount of $2,897.45 as a fair and reasonable additional allowance for depreciation.

17. Topton Electric Light and Power Company—That the depreciable assets of said Topton Electric Light and Power Company for the period beginning April 1, 1928, and ending July 1, 1928, was a sum certain, sufficient to constitute the amount of $854.38 as a fair and reasonable additional allowance for depreciation.

18. Weisenberg Township Electric Light, Heat, and Power Company—That the depreciable assets of said Weisenberg Township Electric Light, Heat, and Power Company for the period beginning April 1, 1928, and ending July 1, 1928, was a sum certain, sufficient to constitute the amount of $174.66 as a fair and reasonable additional allowance for depreciation.

19. Birdsboro Electric Company—That the depreciable assets of said Birdsboro Electric Company for the period beginning April 1, 1928, to July 1, 1928, was a sum certain, sufficient to constitute
11 the amount of $375.82 as a fair and reasonable additional allowance for depreciation.

20. Boyertown Electric Company—That the depreciable assets of said Boyertown Electric Company for the period beginning April 1, 1928, and ending April 1, 1928, was a sum certain, sufficient to constitute the amount of $2,227.85 as a fair and reasonable additional allowance for depreciation.

21. Annville & Palmyra Electric Light Company—That the depreciable assets of said Annville & Palmyra Electric Light Company for the period beginning April 1, 1928, and ending July 1, 1928, was a sum certain, sufficient to constitute the amount of $1,585.22 as a fair and reasonable allowance for depreciation.

22. Bernville Light, Heat & Power Company—That the depreciable assets of said Bernville Light, Heat & Power Company for the period beginning April 1, 1928, and ending July 1, 1928, was a sum certain, sufficient to constitute the amount of $360.55 as a fair and reasonable allowance for depreciation.

23. Berks-Lehigh Electric Company—That the depreciable assets of said Berks-Lehigh Electric Company for the period beginning April 1, 1928, to July 1, 1928, was a sum certain, sufficient to constitute the amount of $541.11 as a fair and reasonable allowance for depreciation.

24. Blue Mountain Electric Company—That the depreciable assets of said Blue Mountain Electric Company for the period beginning April 1, 1928, and ending July 1, 1928, was a sum certain, suffi-
12 cient to constitute the amount of $2,371.30 as a fair and reasonable allowance for depreciation.

25. Pennsylvania Edison Company—That the depreciable assets of said Pennsylvania Edison Company for the period beginning January 1, 1928, and ending March 1, 1928, was a sum certain, sufficient to constitute the amount of $54,640.61 as a fair and reasonable additional allowance for depreciation.

26. Pennsylvania Edison Company—That during the period beginning January 1, 1928, and ending March 1, 1928, said Pennsylvania Edison Company sold miscellaneous capital assets and sustained a loss of $1,347.29 on said sale. The respondent failed to allow said loss as a deduction from income in determining taxable net income for the calendar year 1928.

B. Petitioner's income—Facts as to erroneous and illegal increases in taxable net income of your petitioner by respondent:

1. The respondent erroneously and illegally increased taxable net income by failing to deduct therefrom premium and unamortized debt discount and expense amounting to $551,742.90; said expense was incurred during the calendar year 1927 by reason of the calling and retiring of a portion of your petitioner's funded debt.

2. That during the calendar year 1927 your petitioner sold miscellaneous capital assets and sustained a loss of $230,728.32 on said sale. The respondent failed to allow said loss as a deduction from income in determining taxable net income for the calendar year 1927.

3. That the depreciable assets of your petitioner for the cal-
13 endar year 1927 was a sum certain, sufficient to constitute the amount of $530,895.01 as a fair and reasonable additional allowance for depreciation.

4. That the depreciable assets of your petitioner for the calendar year 1928 was a sum certain, sufficient to constitute the amount of $814,176.18 as a fair and reasonable additional allowance for depreciation.

5. The respondent erroneously and illegally increased taxable net income by failing to deduct therefrom premium and unamortized debt discount and expense amounting to $2,455,855.85. Said expense was incurred during the calendar year 1928 by reason of the calling and retiring of a portion of your petitioner's funded debt.

6. That during the calendar year 1928 your petitioner sold miscellaneous capital assets and sustained a loss of $75,338.80 on said sale. The respondent failed to allow said loss as a deduction from income in determining taxable net income for the calendar year 1928.

C. Final closing agreement.

1. That on or about December 27, 1929, the respondent prepared and submitted to your petitioner and its affiliated taxpayers a closing agreement fixing the income tax liability of your petitioner and its affiliated taxpayers for the calendar year 1927 and/or parts thereof as more fully appears from said agreement.

2. That on or about December 27, 1929, your petitioner and its affiliated taxpayers executed said agreement and delivered it to J. S. Stackhouse of the office of the Internal Revenue Agent in Charge, Gimbel Building, Philadelphia, Pa.

14 D. Final closing agreement.

1. That on or about April 28, 1930, the respondent prepared and submitted to your petitioner and its affiliated taxpayers a closing agreement fixing the income tax liability of your petitioner and its affiliated taxpayers for the calendar year 1928 and/or parts thereof as more fully appears from said agreement.

2. Thereafter on May 1, 1930, your petitioner and its affiliated taxpayers executed said agreement with stipulation waiving the right to appeal to the United States Board of Tax Appeals and consenting to an immediate assessment of the additional tax of $370.33 shown by said agreement upon condition that said agreement was accepted and approved as required by law.

3. That thereafter and pursuant to said agreement the respondent caused to be levied an additional assessment in accordance with said agreement.

4. On or about May 28, 1930, your petitioner paid said assessment pursuant to the aforesaid agreement.

E. That on or about May 28, 1930, in response to a notice and demand received from Joseph S. MacLaughlin, Collector of Internal Revenue, First District, Pennsylvania, Philadelphia, Pa., your petitioner forwarded him a check in the amount of $397.35 representing $370.33 additional tax for 1928 in accordance with final agreement fixing tax liability executed by your petitioner and its affiliated taxpayers on May 1, 1930, and interest amounting to $27.02.

Wherefore, your petitioner prays that your Honorable Board may hear and determine its petition; that the determination of the
15 respondent contained in said deficiency letter be redetermined, set aside, disallowed, and disapproved by your Honorable Board, granting unto your petitioner a reduction and disallowance of said respondent's deficiencies and refunding or crediting the income tax overpayments and overassessments as follows:

Fiscal period beginning January 1, 1927, and ending December 31, 1927—Overassessment and overpayment $148,027.56.

Fiscal period beginning January 1, 1928, and ending December 31, 1928—Overassessment and overpayment $87,267.57.

To your petitioner and/or its affiliated taxpayers in accordance with agreement between said taxpayers and the law and regulations made and provided, and for such other and further relief as may be just.

All of which is respectfully submitted.

(Signed) FRANCIS J. SWEENEY,
Counsel for the Petitioner,
Post Office Address, Room 2401, 61 Broadway, New York, N. Y.

Dated April 14, 1931.

[*Duly sworn to by J. F. McKenna; jurat omitted in printing.*]

17 *Exhibit A to petition*

NP-2-26-28.

TREASURY DEPARTMENT.
Washington, Mar. 11, 193..

Office of Commissioner of Internal Revenue.

Address Reply to Commissioner of Internal Revenue and Refer to

METROPOLITAN EDISON COMPANY,
412 Washington Street, Reading, Pennsylvania.

SIRS: You are advised that the determination of your tax liability for the years 1927 and 1928 discloses a deficiency of $421,412.88 as shown in the statement attached.

In accordance with section 274 of the Revenue Act of 1926 and section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability for the years in which a deficiency is disclosed.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your returns by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the
18 interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,
Commissioner.
By J. C. WILMER,
Deputy Commissioner.

Enclosures:
Statement.
Form 882.
Form 870.
Schedules 1 to 22, inclusive.

Statement

METROPOLITAN EDISON COMPANY

COMPANIES INCLUDED IN THE CONSOLIDATION

	Returns examined for the years—
Parent (or principal company):	
Metropolitan Edison Company, Reading Pennsylvania	1927 1928
Subsidiary Companies:	
Hanover and McSherrystown Street Railway Company, Reading, Pennsylvania	1927 1928
The Maryland Public Service Company, Reading, Pennsylvania	1927 1928
Pennsylvania Edison Company, Easton, Pennsylvania	1927 Period January 1, 1928 to March 1, 1928
Easton Gas Company, Easton, Pennsylvania	1927 1928
19 Saylorsburgh Light, Heat and Power Company, Easton, Pennsylvania.	1927.
Interurban Gas Company, Easton, Pennsylvania.	1927. 1928.
Pen Argyl Gas Company, Easton, Pennsylvania.	1927.
Central Broadhead Power Company, Easton, Pennsylvania.	1927. 1928.
Monaghan-York Light and Power Company, Reading, Pennsylvania.	Period January 12, 1927, to December 31, 1927.
Jackson-York Light and Power Company, Reading, Pennsylvania.	Period January 12, 1927, to December 31, 1927.
Cooke-Cumberland Light and Power Company, Reading, Pennsylvania.	Period January 12, 1927, to December 31, 1927.
North Cornwall Lebanon Light and Power Company, Reading, Pennsylvania.	Period January 12, 1927, to December 31, 1927.

	Washington Berks Electric Company, Reading, Pennsylvania.	1927.
	Hereford Township Electric Company, Reading, Pennsylvania.	1927.
	Dickinson-Cumberland Light and Power Company, Reading, Pennsylvania.	Period January 12, 1927, to December 31, 1927.
	Bridgeton-Bucks Light and Power Company, Reading, Pennsylvania.	Period March 11,, 1927, to December 31, 1927.
	Tinicum Township Edison Company, Reading, Pennsylvania.	Period June 22, 1927, to December 31, 1927.
20	Delaware Pike Electric Company, Reading, Pennsylvania.	Period August 17, 1927, to December 31, 1927.
	Spring Grove-York Light and Power Company, Reading, Pennsylvania.	Period January 12, 1927, to December 31, 1927.
	Heidleberg-York Light and Power Company, Reading, Pennsylvania.	Period January 12, 1927, to December 31, 1927.
	Hamilton-Adams Light and Power Company, Reading, Pennsylvania.	Period January 12, 1927, to December 31, 1927.
	Nockamixon-Bucks Light and Power Company, Reading, Pennsylvania.	Period March 11, 1927, to December 31, 1927.
	Metropolitan Power Company, Reading Pennsylvania.	1927.
	Bernville Light, Heat and Power Company, Reading, Pennsylvania.	Period April 1, 1928, to July 1, 1928.
	French Creek Electric Company, Reading, Pennsylvania.	Period April 1, 1928, to July 1, 1928.
	Hamburg Gas and Electric Company, Reading, Pennsylvania.	Period April 1, 1928, to July 1, 1928.
	Topton Electric Light and Power Company, Reading, Pennsylvania.	Period April 1, 1928, to July 1, 1928.
	Weisenberg Township Electric Light and Power Company, Reading, Pennsylvania.	Period April 1, 1928, to July 1, 1928.
	Birdsboro Electric Company, Reading, Pennsylvania.	Period April 1, 1928, to July 1, 1928.
21	Ortanna Electric Light and Power Company, Reading, Pennsylvania.	Period April 1, 1928, to July 1, 1928
	Boyertown Electric Light and Power Company, Reading, Pennsylvania.	Period April 1, 1928, to July 1, 1928
	Annville and Palmyra Electric Light Company, Reading Pennsylvania.	Period April 1, 1928, to July 1, 1928
	Berks-Lehigh Electric Company, Reading, Pennsylvania.	Period April 1, 1928, to July 1, 1928
	Blue Mountain Electric Company, Reading, Pennsylvania.	Period April 1, 1928, to July 1, 1928

TAX LIABILITY

Year	Tax liability	Tax assessed	Deficiency
1927	$367,744.24	$266,349.00	$101,395.24
1928	406,887.86	86,870.22	320,017.64
Total	$774,632.10	$353,219.22	$421,412.88

Full details of the adjustments producing the above-stated results are contained in the attached schedules 1 to 22, inclusive, and in revenue agent's reports dated September 9, 1929, and March 1, 1930, copies of which have been furnished you, and which are hereby made a part of this letter.

Due to the fact that the statute of limitations will presently bar any assessment of additional tax against you for years 1927 and 1928, the Bureau will be unable to afford you an opportunity under

the provisions of article 1211 of Regulations 69, and/or article
22 451 of Regulations 74 to discuss your case before mailing formal notice of its determination as provided by section 274 (a) of the Revenue Act of 1926 and/or section 272 (a) of the Revenue Act of 1928. It is, therefore, necessary at this time to issue this formal notice of deficiency.

The following claims for refund have been given careful consideration in the determination of the results set forth in this letter and will be made the basis of separate communications addressed to the companies which filed the claims.

Company	Year	Date filed	Amount
Metropolitan Edison Company	1927	February 26, 1930	$54,144.22
Metropolitan Edison Company	1927	February 26, 1930	36,906.58
Pen Argyl Gas Company	1927	February 28, 1930	21.66
Interurban Gas Company	1927	February 26, 1930	182.79
Pennsylvania Edison Company	1927	February 26, 1930	17,477.54
Saylorsburg Light and Power Company	1927	February 26, 1930	11.70

The entire tax liability has been allocated to the Metropolitan Edison Company in accordance with agreements filed under sections 240 and 142 of the Revenue Acts of 1926 and 1928 respectively.

Copies of the attached letter, together with a copy of the statement and schedules have been mailed to your representatives, Miller and Chevalier, Southern Building, Washington, D. C., and H. C. Hobson, 61 Broadway, New York, New York, in accordance with the authority conferred upon them in the powers of attorney executed by you and on file in this office.

The additional depreciation is allowed herein with the specific understanding that same will be recorded permanently in your accounts in accordance with Article 209 of Regulations 74.

23 SCHEDULE 1

METROPOLITAN EDISON COMPANY—YEAR ENDED DECEMBER 31, 1927

NET INCOME

Net income as disclosed by return		$1,558,116.58
As corrected		2,200,333.93
Net adjustment		$642,217.35
Unallowable deductions and additional income:		
(a) Reserve for injuries and damages	$327.80	
(b) Fee paid on capital stock issued	18,768.96	
(c) Premium paid and unamortized discount on bonds retired	551,742.90	
(d) Loss on property retired	230,728.32	
Total		$801,567.98
Nontaxable income and additional deductions:		
(e) Additional depreciation allowed	$159,350.63	
Total		$159,350.63
Net adjustment as above		$642,217.35

SCHEDULE 1-A

EXPLANATION OF ITEMS CHANGED

(a) This amount represents the excess of payments over accruals on account of injuries and damages, and is computed as follows:

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Total payments	$11,919.74
Total accruals	10,800.00
Excess payments deducted on return	$1,119.74
Actual excess of payment	791.94
Adjustment as above	$327.80

(b) Fees paid to state of Pennsylvania on account of the increase of the capital stock of a corporation are capital expenditures and are not deductible in computing net income.

Authority, decision of United States Board of Tax Appeals in the case of Logan-Gregg Hardware Company, Volume 2, page 647.

(c) This amount represents premium paid and unamortized discount on $3,250,000.00, 1st Refunding 6% Gold Bonds, Series A of the Metropolitan Power Company which were redeemed through the issuance on March 1, 1928, of $23,000,000.00 1st Refunding 4½% Gold Bonds, Series D, maturing on March 1, 1968, and is disallowed as a deduction for income tax purposes for the reason that the Bureau holds that where bonds are retired through the proceeds of another issue of bonds sold for the specific purpose of effecting such retirement, the unamortized portion of discount and expense of the previous issue becomes an expense incidental to the issuing of the new bonds and should, therefore, be amortized over the life of the new bonds.

(d) As you have failed to establish the cost or by what means the March 1, 1913, value claimed is determined for the items involved in this amount, and also since the provision for depreciation as set up on your books does not permit the determination of the

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intervening exhaustion on the assets retired, the loss claimed on your return is disallowed as in the absence of such essential data there is no means by which the Bureau can determine any allowable loss.

(e) Depreciation has been revised in accordance with rate acceptable to the Bureau and is computed as follows:

Original Property Account December 31, 1917	$6,361,266.15
Additions, Year 1918	763,131.39
Additions, Year 1919	254,697.41
Additions, Year 1920	936,306.84
Additions, Year 1921	110,600.58
Additions, Year 1922	819,996.10
Additions, Year 1923	3,594,316.81
Additions, Year 1924	1,536,805.49
Additions, Year 1925	1,711,033.42
Additions, Year 1926	8,890,707.48
Total depreciable assets as at December 31, 1926	$24,978,861.67

Depreciation at 2½ per cent		$624,471.54
Additions, year 1927 at 1¼ per cent	$1,723,298.02	21,541.22
Additions, year 1927 at 1¼ per cent for 10 months	5,261,037.92	54,802.48
Additional depreciation allowable		$159,350.63
Depreciation deducted in return		541,464.61
Additional depreciation allowable		$159,350.63

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SCHEDULE 2

PENNSYLVANIA EDISON COMPANY—YEAR ENDED DECEMBER 31, 1927

NET INCOME

Net income as disclosed by return		$352,734.92
As corrected		445,553.43
Net adjustment		$92,818.51
Unallowable deductions and additional income:		
(a) Injuries and damage payment refunded	$40.95	
(b) Loss on property retired	92,517.85	
(c) Fire loss Bangor Plant	101,800.61	
Total		$194,359.41
Nontaxable income and additional deductions:		
(d) Additional depreciation	$101,540.90	
Total		101,540.90
Net adjustment as above		$92,818.51

SCHEDULE 2-A

EXPLANATION OF ITEMS CHANGED

(a) This amount represents an adjustment on account of overpayment of injuries and damages.

(b) For explanation of this adjustment see item (d) schedule 1-A.

(c) For explanation of this adjustment see item (d) schedule 1-A.

(d) Depreciation has been adjusted at rates acceptable to the Bureau as follows:

Original Plant account at December 31, 1915	$6,609,174.59	
Depreciation at 1½%		$99,137.62
27 Additions—years 1916 to 1926	4,288,035.34	
Depreciation at 2½%		107,200.88
Additions, year 1927	491,658.69	
Depreciation at 1¼%		6,145.73
Total depreciation allowable		$212,484.23
Depreciation deducted on return		110,943.33
Additional depreciation allowable		$101,540.90

SCHEDULE 3

EASTON GAS WORKS—YEAR ENDED DECEMBER 31, 1927

NET INCOME

Net income as disclosed by return		$62,773.50
As corrected		77,593.00
Net adjustment		$14,819.50
Unallowable deductions and additional income:		
(a) Depreciation disallowed	$1,968.87	
(b) Prior year loss	3,731.04	
(c) Loss on property retired	9,119.59	
Total		$14,819.50

SCHEDULE 3-A

EXPLANATION OF ITEMS CHANGED

(a) Depreciation has been adjusted at rates acceptable to the Bureau as follows:

Total depreciable assets as of December 31, 1912	$1,021,884.93	
Depreciation at 2½%		$25,547.12
Additions, December 31, 1912, to December 31, 1923	177,138.26	
Depreciation at 2½%		4,428.46
Additions, year 1924	261,969.93	
Depreciation at 2½%		3,274.62
Additions, year 1925	168,235.63	
Depreciation at 2½%		4,205.89
Additions, year 1926	115,228.57	
Depreciation at 2½%		2,880.71
Additions, year 1927	215,546.08	
Depreciation at 1¼%		2,694.33
Total depreciation allowable		$43,031.13
Depreciation deducted on return		45,000.00
Depreciation disallowed		$1,968.87

(b) This item represents a portion of loss on sale of property incurred in the year 1920 which you have amortized over a ten-year period.

Since the loss was not incurred during the taxable year no deduction therefore can be allowed. Reference, article 112, Regulations 69.

The computation follows:

Prior year loss deducted	$14,663.04
Amount reported unallowable	10,932.00
Additional amount disallowed	$3,731.04

(c) Same explanation as item (d) schedule 1-A.

SCHEDULE 4

INTERURBAN GAS COMPANY—YEAR ENDED DECEMBER 31, 1927

NET INCOME

Net income as disclosed by return	$4,423.71
As corrected	$4,006.73
Net adjustment	$416.98
Nontaxable income and additional deductions:	
(a) Additional depreciation	$416.98

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SCHEDULE 4-A

EXPLANATION OF ITEMS CHANGED

(a) Depreciation has been adjusted at rates acceptable to the Bureau as follows:

Additions 1916 to 1926, inclusive	$15,190.76	
Depreciation at 2½%		$379.77
Additions, year 1927	2,976.47	
Depreciation at 1¼%		37.21
Total depreciation allowable		$416.98
Depreciation deducted on return		None
Additional depreciation allowable		$416.98

SCHEDULE 5

METROPOLITAN POWER COMPANY—YEAR ENDED DECEMBER 31, 1927

NET INCOME

Net loss as disclosed by return	$(23,085.43)
As corrected—loss	(21,447.96)
Net adjustment	$1,637.47
Unallowable deductions and additional income:	
(a) Depreciation disallowed	$1,637.47

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SCHEDULE 5-A

EXPLANATION OF ITEMS CHANGED

(a) Depreciation has been adjusted on basis of rates acceptable to the Bureau of follows:

Additions: January 1, 1923, to December 31, 1923	$897,268.12	
Depreciation at 2½%		$22,431.70
Additions, year 1924	2,368,826.24	
Depreciation at 2½%		59,220.66
Additions, year 1925	516,115.95	
Depreciation at 2½%		12,902.90
Additions, year 1926	1,426,208.92	
Depreciation at 2½%		35,655.22
Additions, year 1927	52,618.69	
Depreciation at 1¼%		657.73
Depreciation allowable for year		$130,868.21
¼ths of above applicable for period		$21,811.37
Depreciation deducted on return		23,448.84
Depreciation disallowed		$1,637.47

Depreciation for the period March 1, to December 31, 1927, included in item (e) of schedule 1-A.

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SCHEDULE 6

METROPOLITAN EDISON COMPANY—YEAR ENDED DECEMBER 31, 1927

CONSOLIDATED NET INCOME—NET INCOME AS CORRECTED

Schedule	Company	
1	Metropolitan Edison Company	$2,200,333.93
Return	Hanover and McSherrystown Street Railway Co.	14,364.37
Return	The Maryland Public Service Company	904.39
2	Pennsylvania Edison Company	445,553.42
Return	Saylorsburg Light and Power Company	2,011.72
3	Easton Gas Works	77,593.00
4	Interurban Gas Company	4,008.73
Return	The Pen Argyl Gas Company	711.61
Return	Central Broadhead Power Company	None
Return	Monaghan York Light and Power Company	None
Return	Jackson-York Light and Power Company	None
Return	Cooke-Cumberland Light and Power Company	None
Return	North Cornwall-Lebanon Light and Power Company	None
Return	Washington Berks Electric Company	None
Return	Hereford Township Electric Company	None
Return	Dickinson Cumberland Light and Power Company	None
Return	Bridgeton-Bucks Light and Power Company	None
Return	Tinicum Township Edison Company	None
32 Return	Delaware Pike Electric Company	None
Return	Spring-Grove York Light and Power Company	None
Return	Heidelberg-York Light and Power Company	None
Return	Hamilton-Adams Light and Power Company	None
Return	Neckamixon-Bucks Light and Power Company	None
	Total net income	$2,745,479.38
5	Net Loss as Corrected, Metropolitan Power Company	21,447.96
	Net consolidated income as corrected	$2,724,031.42

SCHEDULE 7

METROPOLITAN EDISON COMPANY

RECONCILIATION OF CONSOLIDATED SURPLUS—YEAR 1927

	Metropolitan Edison Company	Hanover and McSherrystown Street Railway Company	Maryland Public Service	Pennsylvania Edison Company	Saylorsburg Light and Power Company	Easton Gas Works	Interurban Gas Company	Metropolitan Power Company	The Pen Argyl Gas Company	Total
Surplus reported December 31, 1926	$2,692,804.76	$138,831.18	$1,198.62	$375,102.38	$41,031.65	$102,289.24	$5,244.20	($117,239.46)	$11,060.30	$3,250,322.87
Net income as corrected	2,200,333.93	14,364.37	904.59	445,553.43	2,011.72	77,593.00	4,006.73	(21,447.96)	711.61	2,734,031.42
Nontaxable income and additional deductions:										
Dividends	526,498.56			40,940.00						566,438.56
Interest during construction	90,942.51			16,195.79		1,221.76				108,360.06
Stamp taxes	1,670.50			1,102.50						2,773.00
Reserve for injuries and damages	791.94	(1,064.57)		(969.00)						(1,341.63)
Additional depreciation	159,350.63			101,840.90		(1,968.87)	416.98	(1,637.47)		257,702.17
Bond discount				2,516.85						2,516.85
Surplus of Saylorsburg Light and Power Company and Pen Argyl Gas Company				42,698.37		11,771.91				54,470.28
Total	$5,671,392.83	$152,130.98	$2,103.21	$1,024,681.22	$43,043.37	$190,907.04	$9,667.91	($140,324.89)	$11,771.91	$6,965,373.58
Unallowable deductions and additional income:										
Dividends paid	$2,061,796.53			$472,998.56		$40,940.00				$2,575,735.09
Deficit of Metropolitan Power Company	140,802.03									140,802.03
Federal income taxes	325,915.42	$600.00	$120.00	55,..50.00	$345.00	7,750.00				389,980.42
Tax on tax free bonds	16,713.79	4.00		2,100.00				$477.14		19,294.93
Premium on stock of Saylorsburg Light and Power Company and Pen Argyl Gas Company				32,900.00		2,500.00				35,400.00
Injuries and damages refunded				40.95						40.95
Adjustment of 1926 donations						13,220.16	$329.25			13,220.16
Prior year loss						14,663.04				14,992.29
Total	$2,545,227.77	$604.00	$120.00	$563,289.51	$345.00	$79,073.20	$329.25	$477.14	0	$3,189,865.87
Surplus reported December 31, 1927	$3,126,165.06	$151,526.98	$1,983.21	$461,391.71	$42,698.37	$111,833.84	$9,338.66	($140,802.03)	$11,771.91	$3,775,907.71

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SCHEDULE 8

COMPUTATION OF TAX

INCOME TAX

Net income for taxable year	$2,724,031.42
Balance subject to tax	2,724,031.42
Income tax 13½ per cent	367,744.24
Total tax assessable	367,744.24
Total previously assessed	266,349.00
Additional tax to be assessed	$101,395.24

SCHEDULE 9

YEAR ENDED DECEMBER 31, 1928

NET INCOME

Net income as disclosed by return		$525,710.53
As corrected		3,164,203.12
Net adjustment		$2,638,492.59
Unallowable deductions and additional income:		
(a) Depreciation disallowed	$119,018.16	
(b) Unamortized discount and expense	2,455,855.85	
(c) Loss on property retired	75,338.00	
Total		$2,650,212.01
Nontaxable income and additional deductions:		
(d) Adjustment for taxes	$11,435.47	
(e) Injuries and damages	283.95	
Total		11,719.42
Net adjustment as above		$2,638,492.59

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SCHEDULE 9-A

EXPLANATION OF ITEMS CHANGED

(a) Depreciation has been adjusted on basis of rates satisfactory to the Bureau, as follows:

Original Property Account—December 31, 1917		$6,361,266.15
Additions, year 1918		763,131.39
Additions, year 1919		254,607.41
Additions, year 1920		936,396.84
Additions, year 1921		110,600.58
Additions, year 1922		819,996.10
Additions, year 1923		3,504,316.81
Additions, year 1924		1,536,405.49
Additions, year 1925		1,711,033.42
Additions, year 1926		8,890,707.48
Additions, year 1927		6,984,335.94
Total depreciable assets as at December 31, 1927		$31,963,197.61
Depreciation at 2½%		799,079.94
Additions, year 1928	$1,353,335.41	
Depreciation at 1¼% (6 months)		8,458.34
Properties merged during the year: Pennsylvania Edison Company, merged March 1, 1928.		
Original Plant Account at December 31, 1915	$6,609,174.59	
Depreciation at 1½% for 10 months		82,614.68
Additions, 1916 to 1927, inclusive	$4,779,694.03	
Depreciation at 2½% for 10 months		99,576.95

37	Hamburg Gas and Electric Company, merged July 1, 1928:		
	Original property account	$179,872.28	
	Depreciation at 1½% for 6 months		$1,349.04
	Additions December 21, 1919, to December 31, 1927	295,035.68	
	Depreciation at 2½% for 6 months		3,687.94
	Additions January 1, 1928, to June 30, 1928	18,111.63	
	Depreciation at 1¼% for 6 months		113.19
	Topton Electric Light and Power Company, merged July 1, 1928:		
	Original property account	81,108.02	
	Depreciation at 1½% for 6 months		608.30
	Additions December 31, 1921, to December 31, 1927	40,954.19	
	Depreciation at 2½% for 6 months		511.93
	Additions January 1, 1928, to June 30, 1928	5,995.70	
	Depreciation at 1¼% for 6 months		37.47
38	Weisenberg Township Electric Light and Power Company, merged July 1, 1928:		
	Original property account	$19,172.62	
	Depreciation at 1½% for 6 months		143.79
	Retirement of original property account at 1½%	(2,040.44)	(15.30)
	Additions to December 31, 1923, to December 31, 1927	235.33	
	Depreciation at 2½% for 6 months		2.94
	Additions January 1, 1928, to June 30, 1928	120.83	
	Depreciation at 1¼% for 6 months		.75
	Bernville Heat, Light and Power Company, merged July 1, 1928:		
	Original property account	19,020.63	
	Depreciation at 1½% for 6 months		142.65
	Additions December 31, 1922, to December 31, 1927	13,926.40	
	Depreciation at 2½% for 6 months		174.08
	Additions January 1, 1928, to June 30, 1928	1,670.14	
	Depreciation at 1¼% for 6 months		10.44
39	Blue Mountain Electric Company, merged July 1, 1928:		
	Original property account	$98,612.02	
	Depreciation at 1½% for 6 months		739.59
	Retirement original property account at 1½% for 6 months	(300.02)	(2.25)
	Additions December 31, 1920 to December 31, 1927	95,322.66	
	Depreciation at 2½% for 6 months		1,191.53
	Additions January 1, 1928 to June 30, 1928	4,996.36	
	Depreciation at 1¼% for 6 months		31.23
	Boyertown Electric Company, merged July 1, 1928:		
	Original property account	75,493.67	
	Depreciation at 1½% for 6 months		566.20
	Retirement original property account at 1½% for 6 months	(9,050.53)	(67.88)
	Additions July 1, 1916, to December 31, 1927	240,339.20	
	Depreciation at 2½% for 6 months		3,004.24
	Additions January 1, 1928 to June 30, 1928	32,232.75	
	Depreciation at 1¼% for 6 months		201.45
40	Annville and Palmyra Electric Company merged July 1, 1928:		
	Original property account	$152,942.25	
	Depreciation at 1½% for 6 months		1,147.07
	Additions July 31, 1921 to December 31, 1927	48,182.76	
	Depreciation at 2½% for 6 months		602.28
	Additions January 1, 1928 to June 30, 1928	3,744.39	
	Depreciation at 1¼% for 6 months		23.40

The French Creek Electric Company, merged July 1, 1928:		
Original property account	$5,000.00	
Depreciation at 1½% for 6 months		$37.50
Additions December 31, 1918 to December 31, 1927	5,623.62	
Depreciation at 2½% for 6 months		70.30
Additions January 1, 1928 to June 30, 1928	344.18	
Depreciation at 1¼% for 6 months		2.15
41 Birdsboro Electric Company, merged July 1, 1928:		
Original property account	$24,061.48	
Depreciation at 1½% for 6 months		180.46
Retirement, original property account at 1½%	(5,077.36)	(38.08)
Additions December 31, 1918 to December 31, 1927	30,361.48	
Depreciation at 2½% for 6 months		379.52
Additions January 1, 1928 to June 30, 1928	3,524.24	
Depreciation at 1¼% for 6 months		22.03
Berks Lehigh Electric Company, merged July 1, 1928:		
Original property account	27,964.97	
Depreciation at 1½% for 6 months		209.74
Additions December 31, 1922 to December 31, 1927	10,732.40	
Depreciation at 2½% for 6 months		134.16
Additions January 1, 1928 to June 30, 1928	1,626.86	
Depreciation at 1¼% for 6 months		10.17
42 Ortanna Electric Light and Power Company, merged July 1, 1928:		
Original property account	$49,977.07	
Depreciation at 1½% for 6 months		374.83
Retirement original property account at 1½% for 6 months	(706.84)	(5.30)
Additions December 21, 1923, to December 31, 1927	25,565.03	
Depreciation at 2½% for 6 months		319.56
Additions January 1, 1928, to June 30, 1928	1,208.31	
Depreciation at 1¼% for 6 months		7.55
Total depreciation allowable		$1,005,638.58
Depreciation deducted on return		1,124,656.74
Depreciation disallowed		$119,018.16
(b) Premium paid and unamortized discount on bonds retired in 1927 and 1928		$3,068,410.61
Less: Amount claimed in 1927		551,742.90
Balance claimed in 1928		$2,516,667.71
Less: Amount amortized and charged to expense but not claimed on return, herein allowed		60,811.86
Amount disallowed		$2,455,855.85

43 This adjustment is based on Exhibit CL and CM attached to revenue agent's report dated March 1, 1930, a copy of which has been furnished you and is herewith made a part of this letter.

The premium paid and the unamortized discount on bonds which were redeemed through the issuance on March 1, 1928, of your 1st Refunding 5 per cent Gold Series C 40-year bonds is not an allowable deduction for the year 1928 but should be amortized over the life of the new issue.

The deduction for amortization as computed by you on the amount of $3,068,410.61, but which was not claimed as a deduction on your return has been allowed as indicated above.

(c) For explanation of this adjustment see item (d), schedule 1-A.

(d) This item shown on your return as an unallowable deduction apparently representing a refund of fee paid in prior years on stock issue, is deemed an allowable deduction. Since this item was not allowed as a deduction when incurred it follows that the cancellation thereof, conversely, does not represent taxable income.

(e) This amount represents the excess of payments over accruals account of injuries and damages and is computed as follows:

Total payments	$32,234.58
Total accruals	31,950.63
Adjustment as above	$283.95

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SCHEDULE 10

EASTON GAS WORKS—YEAR ENDED DECEMBER 31, 1928

NET INCOME

Net income as disclosed by return		$40,536.55
As corrected		55,618.56
Net adjustment		$15,082.01
Unallowable deductions and additional income:		
(a) Prior year loss	$14,663.04	
(b) Depreciation disallowed	418.97	
Total		$15,082.01

SCHEDULE 10-A

EXPLANATION OF ITEMS CHANGED

(a) For explanation of this adjustment see item (b), schedule 3-A. Reference, Article 342 of Regulations 74.

(b) Depreciation has been adjusted on basis of rates satisfactory to the Bureau as follows:

Total depreciable assets as of December 31, 1912	$1,021,884.93	
Depreciation at 2½%		$25,547.12
Additions, December 31, 1912, to December 31, 1923	177,138.26	
Depreciation at 2½%		4,428.46
Additions, year 1924	261,969.93	
Depreciation at 2½%		6,549.25
Additions, year 1925	168,235.63	
Depreciation at 2½%		4,205.89
Additions, year 1926	115,228.57	
Depreciation at 2½%		2,880.71
45 Additions, year 1927	215,546.08	
Depreciation at 2½%		5,388.66
Additions, year 1928	71,016.12	
Depreciation at 1¼%		887.70
Total depreciation allowable		$49,887.79
Depreciation deducted on return		50,306.76
Depreciation disallowed		$ 418.97

SCHEDULE 11

INTERURBAN GAS COMPANY—YEAR ENDED DECEMBER 31, 1928

NET INCOME

Net income as disclosed by return		$5,208.1
As corrected		6,181.0
Net adjustment		$ 972.9
Unallowable deductions and additional income: (a) Depreciation disallowed	$972.93	

SCHEDULE 11-A

EXPLANATION OF ITEMS CHANGED

(a) Depreciation has been computed on basis of rates acceptable to the Bureau as follows:

Additions 1916 to 1927, inclusive	$18,167.23	
Depreciation at 2½%		$ 454.1
Additions, year 1928	444.85	
Depreciation at 1¼%		5.5
Total depreciation allowable		$ 459.7
Depreciation deducted on return		1,432.6
Depreciation disallowed		$ 972.9

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SCHEDULE 12

HANOVER AND MCSHERRYSTOWN STREET RAILWAY COMPANY—YEAR ENDED DECEMBER 31, 1928

NET INCOME

Net income as disclosed by return		$4,694.8
As corrected		4,725.6
Net adjustment		$ 30.8
Unallowable deductions and additional income: (a) Depreciation disallowed		$ 30.8

SCHEDULE 12-A

EXPLANATION OF ITEMS CHANGED

(a) Depreciation has been adjusted at rates acceptable to the Bureau as follows:

Original property account at April 1, 1923	$265,504.96	
Depreciation at 1½%		$3,982.5
Additions from April 1, 1923, to December 31, 1927	2,360.00	
Depreciation at 2½%		59.0
Additions, year 1928	7,605.30	
Depreciation at 1¼%		95.0
Total depreciation allowable		$4,136.6
Depreciation deducted on return		4,167.4
Depreciation disallowed		$ 30.8

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SCHEDULE 13

THE MARYLAND PUBLIC SERVICE COMPANY—YEAR ENDED DECEMBER 31, 1928

NET INCOME

Net income as disclosed by return		$673.82
As corrected		731.51
Net adjustment		$57.69
Unallowable deductions and additional income: (a) Depreciation disallowed		$57.69

SCHEDULE 13-A

EXPLANATION OF ITEMS CHANGED

Depreciation has been adjusted at rates acceptable to the Bureau as follows:

Total depreciable assets at December 31, 1927	$11,403.44	
Depreciation at 2½%		$285.09
Additions, year 1928	289.21	
Depreciation at 1¼%		3.36
Depreciation allowable		$288.45
Depreciation deducted in return		346.14
Depreciation disallowed		$57.69

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SCHEDULE 14

HAMBURG GAS AND ELECTRIC COMPANY—PERIOD APRIL 1, 1928, TO JULY 1, 1928

NET INCOME

Net income as disclosed by return		$16,411.15
As corrected		17,963.88
Net adjustment		$1,552.73
Unallowable deductions and additional income: (a) Depreciation disallowed		$1,552.73

SCHEDULE 14-A

EXPLANATION OF ITEMS CHANGED

(a) Depreciation has been adjusted on basis of rates acceptable to the Bureau as follows:

Original property account December 31, 1919	$179,872.28	
Depreciation at 1½% for three months		$674.52
Additions, December 31, 1919, to December 31, 1927	295,035.68	
Depreciation at 2½% for three months		1,843.97
Additions, January 1, 1928, to June 30, 1928	18,111.63	
Depreciation at 1¼% for three months		56.60
Depreciation allowable		$2,575.09
Depreciation taken on return		84,127.82
Depreciation disallowed		$1,552.73

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SCHEDULE 15

TOPTON ELECTRIC LIGHT AND POWER COMPANY—PERIOD APRIL 1, 1928, TO JULY 1, 1928

NET INCOME

Net income as disclosed by return		$2,714.4
As corrected		3,289.4
Net adjustment		$575.0
Unallowable deductions and additional income: (a) Depreciation disallowed		$575.0

SCHEDULE 15-A

EXPLANATION OF ITEMS CHANGED

(a) Depreciation has been adjusted at rates acceptable to the Bureau as follows:

Original property account at December 31, 1921	$81,106.02	
Depreciation at 1½% for three months		$304.1
Additions, December 31, 1921, to December 31, 1927	40,964.19	
Depreciation at 2½% for three months		255.9
Additions, January 1, 1928, to June 30, 1928	5,905.70	
Depreciation at 1¼% for three months		18.7
Depreciation allowable		$578.8
Depreciation deducted		1,153.8
Depreciation disallowed		$575.0

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SCHEDULE 16

WEISENBURG TOWNSHIP ELECTRIC LIGHT AND POWER COMPANY—PERIOD APRIL 1, 1928, TO JULY 1, 1928

NET INCOME

Net income as disclosed by return		$262.14
As corrected		419.61
Net adjustment		$157.47
Unallowable deductions and additional income: (a) Additional depreciation		$157.47

SCHEDULE 16-A

EXPLANATION OF ITEMS CHANGED

(a) Depreciation has been adjusted at rates acceptable to the Bureau as follows:

Original property account at December 31, 1923	$19,172.62	
Depreciation at 1½% for three months		$71.9
Retirement of original property account	(2,040.44)	
Depreciation at 1½% for three months		(7.6
Additions, December 31, 1923, to December 31, 1927	235.33	
Depreciation at 2½% for three months		1.4
Additions, January 1 to June 30, 1928	120.83	
Depreciation at 1¼% for three months		.3
Depreciation allowable		$66.0
Depreciation deducted on return		223.5
Depreciation disallowed		$157.4

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SCHEDULE 17

BIRDSBORO ELECTRIC COMPANY—PERIOD APRIL 1, 1928, TO JULY 1, 1928

NET INCOME

Net income as disclosed by return		$4,738.71
As corrected		5,066.75
Net adjustment		$328.04
Unallowable deductions and additional income: (a) Depreciation disallowed	$328.04	
Net adjustment as above		$328.04

SCHEDULE 17-A

EXPLANATION OF ITEMS CHANGED

(a) Depreciation has been adjusted on basis of rates acceptable to the Bureau as follows:

Original property account December 31, 1918	$24,061.48	
Depreciation at 1½% for three months		$90.23
Retirement original property account	($5,077.36)	
Depreciation at 1½% for three months		(19.04)
Additions, December 31, 1918, to December 31, 1927	$30,361.48	
Depreciation at 2½% for three months		189.76
Additions, January 1, 1928, to June 30, 1928	$3,524.24	
Depreciation at 1¼% for three months		11.01
Depreciation allowable		$271.96
Depreciation deducted on return		600.00
Depreciation disallowed		$328.04

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SCHEDULE 18

BOYERTOWN ELECTRIC COMPANY—PERIOD APRIL 1, 1928, TO JULY 1, 1928

NET INCOME

Net income as disclosed by return		$6,967.21
As corrected		10,495.83
Net adjustment		$3,528.62
Unallowable deductions and additional income: (a) Depreciation disallowed	$3,528.62	
Net adjustment as above		$3,528.62

SCHEDULE 18-A

EXPLANATION OF ITEMS CHANGED

(a) Depreciation has been adjusted on basis of rates acceptable to the Bureau as follows:

Original property account July 1, 1916	$75,493.67	
Depreciation at 1½% for three months		$283.10
Retirements original property account	($9,050.53)	
Depreciation at 1½% for three months		(33.94)
Additions, July 1, 1916, to December 31, 1927	$240,339.20	
Depreciation at 2½% for three months		$1,502.12
Additions, January 1, 1928, to June 30, 1928	$32,232.75	
Depreciation at 1¼% for three months		100.72
Depreciation allowable		$1,852.00
Depreciation deducted on return		5,380.62
Depreciation disallowed		$3,528.62

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SCHEDULE 19

PENNSYLVANIA EDISON COMPANY—PERIOD JANUARY 1, 1928, TO FEBRUARY 28, 1928

NET INCOME

Net income as disclosed by return		$89,177.35
As corrected		95,213.13
Net adjustment		$6,035.78
Unallowable deductions and additional income:		
(a) Depreciation disallowed	$4,688.49	
(b) Loss on property retired	1,347.29	
Net adjustment as above		$6,035.78

SCHEDULE 19-A

EXPLANATION OF ITEMS CHANGED

(a) Depreciation has been computed at rates acceptable to the Bureau as follows:

Original plant account	$6,609,174.59	
Depreciation at 1½% for two months		$16,522.94
Additions, years 1916 to 1926	$4,288,035.34	
Depreciation at 2½% for two months		17,866.82
Additions, year 1927	$491,658.69	
Depreciation at 2½% for two months		2,048.58
Total depreciation allowable		$36,438.34
Depreciation deducted on return		41,126.83
Depreciated disallowed		$4,688.49

(b) For explanation of this item see, item (d) Schedule 1-A.

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SCHEDULE 20

METROPOLITAN EDISON COMPANY—YEAR ENDED DECEMBER 31, 1928

CONSOLIDATED NET INCOME

Net Income as Corrected:	
Schedule 9—Metropolitan Edison Company	$3,164,203.12
Schedule 10—Easton Gas Works	55,618.56
Schedule 11—Interurban Gas Company	6,181.03
Schedule 12—Hanover and McSherrystown Street Railway Company	4,725.64
Schedule 13—The Maryland Public Service Company	731.51
Schedule 14—Hamburg Gas and Electric Company	17,963.88
Schedule 15—Topton Electric Light and Power Company	3,289.45
Schedule 16—Weisenberg Township Electric Light and Power Company	419.61
Schedule 17—Birdsboro Electric Company	5,066.75
Schedule 18—Boyertown Electric Company	10,495.83
Return—Annville and Palmyra Electric Light Company	19,314.26
Return—The French Creek Electric Company	637.65
Return—Bernville Light, Heat, and Power Company	1,138.54

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SCHEDULE 21

METROPOLITAN EDISON COMPANY

CONSOLIDATED RECONCILIATION OF SURPLUS—YEAR 1928

	Metropolitan Edison Company	Easton Gas Works	Interurban Gas Company	Hanover and McSherrystown Street Railway Company	The Maryland Public Service Company	Hamburg Gas and Electric Company	Topton Electric Light and Power Company	Weissenburg Township Electric Light and Power Company	Birdsboro Electric Company	Ontarna Electric Light and Power Company	Boyertown Electric Company	
Surplus reported December 31, 1927	$3, 126, 165. 06	$111, 833. 84	$9, 338. 66	$151, 526. 98	$1, 983. 21	$199, 821. 20	$41, 461. 71	$3, 966. 71	$85, 156. 96	$9, 123. 79	$163, 889. 18	
Net taxable income as corrected	3, 164, 269. 12	55, 818. 56	6, 181. 03	4, 725. 64	731. 51	17, 963. 88	3, 289. 45	419. 61	5, 086. 75	(388. 96)	10, 495. 83	
Nontaxable income and Additional Deductions:												
Dividends received	836, 320. 52											
Interest charged to construction	55, 352. 46											
Reserve for injuries and damages	13, 434. 56	644. 54		(1, 135. 00)								
Additional depreciation allowed	243, 541. 71	4, 987. 79	459. 74	4, 136. 64	288. 45	(1, 552. 73)	(575. 04)	(157. 47)	(228. 04)		(3, 528. 62)	
Reserve for bad debts, charges						79. 01	9. 20		15. 00	18. 83	83. 88	
Total	$7, 297, 217. 45	$172, 983. 73	$15, 979. 43	$159, 254. 26	$3, 003. 17	$216, 311. 36	$44, 185. 32	$4, 248. 76	$89, 910. 67	$8, 543. 46	$170, 940. 27	
Unallowable Deductions and Additional Income:												
Federal income taxes	$444, 161. 37	$5, 000. 00	$400. 00	$600. 00	$120. 00	$200. 00	$75. 00	$20. 00	$600. 00	$75. 00	$1, 350. 00	
Tax on tax-free bonds	13, 900. 00	420. 00		2. 14		12. 00						
Reduction in value of stock acquired	233, 235. 34											
Dividends paid	2, 473, 402. 87	40, 940. 00										
Prior year loss		14, 663. 04										
Surplus of companies merged, transferred						215, 999. 36	44, 110. 72	4, 218. 76	88, 310. 67	8, 468. 46	169, 590. 27	
Total	$3, 164, 699. 58	$62, 023. 04	$400. 00	$602. 14	$120. 00	$216, 311. 36	$44, 185. 32	$4, 248. 76	$89, 910. 67	$8, 543. 46	$170, 940. 27	
Surplus as reported December 31, 1928	$4, 093, 517. 87	$110, 960. 69	$15, 579. 43	$158, 652. 12	$2, 983. 17							

Ontanna Electric Light and Power Company	Bovertown Electric Company	Annville and Palmyra Electric Light Company	The French Creek Electric Company	Bennville Light, Heat and Power Company	Berks-Lehigh Electric Company	Blue Mountain Electric Company	Pennsylvania Edison Company	Total
$9, 123. 79	$163, 899. 18	$115, 128. 74	$2, 948. 43	$12, 503. 63	$13, 196. 71	$55, 957. 73	$461, 391. 71	$4, 545, 005. 16
(598. 96)	10, 495. 83	19, 314. 26	257. 65	1, 138. 54	(132. 73)	6, 471. 95	95, 213. 13	3, 390, 732. 17
							9, 068. 34	665, 588. 86
							258. 29	55, 610. 75
							(1, 053. 41)	11, 889. 71
	(3, 528. 62)						17, 670. 80	263, 843. 23
18. 62	83. 88	64. 45		41. 75		191. 14		503. 06
$8, 543. 46	$170, 940. 27	$134, 307. 45	$3, 187. 08	$13, 683. 92	$13, 046. 98	$62, 620. 82	$582, 548. 86	$8, 933, 172. 94
$75. 00	$1, 350. 00	$750. 00		$125. 00	$75. 00	$800. 00	$10, 000. 00	$465, 271. 37
						3. 00	400. 00	14, 637. 14
								233, 335. 34
							572, 148. 86	3, 086, 491. 73
								14, 663. 04
8, 468. 46	169, 590. 27	133, 757. 45	3, 187. 08	13, 548. 92	12, 971. 98	62, 017. 82		737, 181. 04
$8, 543. 46	$170, 940. 27	$134, 507. 45	$3, 187. 08	$13, 683. 92	$13, 046. 98	$62, 620. 82	$582, 548. 86	$4, 551, 579. 66
								$4, 381, 593. 28

Net Income as Corrected:		
Return—Blue Mountain Electric Company	$6,471.95	
Schedule 19—Pennsylvania Edison Company	95,213.13	
Return—Central Broadheads Power Company	None	
Total net income		$3,391,470.91
Net Losses as Corrected:		
Return—Ortanna Electric Light and Power Company	$598.96	
Return—Berks-Lehigh Electric Company	139.78	
Total net losses		738.74
Consolidated net income as corrected		$3,390,732.17

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SCHEDULE 22

COMPUTATION OF TAX

INCOME TAX

Net income for taxable year	$3,390,732.17
Balance subject to tax	$3,390,732.17
Income tax 12 per cent	$406,887.86
Total tax assessable	$406,887.86
Total previously assessed	86,870.22
Additional tax to be assessed	$320,017.64

Before United States Board of Tax Appeals

Answer

Filed June 10, 1931

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I. Admits the allegations contained in paragraph I.

II. Admits the allegations contained in paragraph II.

III. Admits the allegations contained in paragraph III.

IV. Admits that the taxes in controversy are income taxes for the taxable years 1927 and 1928 and that the notice of deficiency shows deficiencies in said taxes in the respective amounts of $101,395.24 and $320,017.64.

V (A) to (E), inclusive. Denies that the Commissioner has committed any errors as alleged in subparagraphs (A) to (E), inclusive, of paragraph V.

58 VI (A) (1) to (26), inclusive. Denies the allegations contained in subparagraphs (1) to (26), inclusive, of paragraph VI (A).

VI (B) (1) to (6), inclusive. Denies the allegations contained in subparagraphs (1) to (6), inclusive, of paragraph VI (B).

VI (C) (1) and (2). Denies the allegations contained in subparagraphs (1) and (2) of paragraph VI (C).

VI (D) (1) to (4), inclusive. Denies the allegations contained in subparagraphs (1) to (4), inclusive, of paragraph VI (D).

VI (E). Denies the allegations contained in paragraph VI (E).

VII. Denies generally and specifically each and every allegation contained in taxpayer's petition and not hereinbefore admitted, qualified, or denied.

WHEREFORE, it is prayed that the taxpayer's appeal be denied.

(Sgd.) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of Counsel:

EUGENE MEACHAM,
C. E. LOWERY,
Special Attorneys, Bureau of Internal Revenue.

59 **Before United States Board of Tax Appeals**

Docket No. 57869. Promulgated May 14, 1937

METROPOLITAN EDISON COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Findings of fact and opinion

Rendered May 14, 1937

1. A corporation which in a prior year had issued its own bonds at a discount and which in the taxable year redeemed such bonds for cash, at a premium, with funds which it had secured from a new bond issue, is entitled to deduct the unamortized discount and expenses applicable to the bonds redeemed and also is entitled to deduct the premiums incurred and paid in their redemption.

2. In the taxable year certain subsidiaries of petitioner transferred their assets to petitioner. In prior years these subsidiaries had issued bonds at a discount. In the taxable year these subsidiaries redeemed in cash their own bonds with funds advanced by petitioner out of the proceeds of a new bond issue floated by petitioner. Held, that petitioner in a consolidated return filed with said subsidiaries is entitled to deduct the unamortized discount applicable to the bonds redeemed.

3. In the taxable years petitioner called and redeemed at a premium certain bonds which had been issued prior thereto by certain of its subsidiaries, the face value of which bonds petitioner had assumed and agreed to pay in a transfer of the assets of these subsidiaries to petitioner. Held, petitioner is entitled to deduct
60 the amount of the premiums paid in the redemption of these bonds. Coast Counties Gas & Electric Co., 33 B. T. A. 1199, overruled on this point.

4. In the taxable year petitioner liquidated one of its subsidiaries, taking over its assets in exchange for the transfer and cancellation of all its capital stock and assuming all its liabilities, including bonds which in a prior year the subsidiary had sold at a discount and the payment of which petitioner had guaranteed at the time of issuance. Petitioner called the outstanding bonds for redemption. Held, petitioner is not entitled to take as a deduction the unamortized discount and expense applicable to such bonds.

5. In years prior to the taxable year, petitioner had taken over the assets of certain of its subsidiaries under what is termed "short form of merger" under Pennsylvania law. In prior years these subsidiaries had issued bonds at a discount. Held, that the taking over of the assets of the subsidiaries by the parent corporation was in effect a liquidation of the subsidiaries in consideration of the transfer and cancellation of all their capital stock and the assumption by petitioner

of all their liabilities, including the outstanding bonds, and does not come under the rule governing the consolidation of corporations. Held, further, petitioner is not entitled to take as a deduction in the taxable year on its consolidated return the unamortized discount and expenses applicable to these bonds.

6. Prior to the taxable year, three certain corporations chartered under Pennsylvania law merged and consolidated under Pennsylvania statutes to form petitioner and thereupon petitioner succeeded by operation of law to all the rights, privileges, assets, and liabilities of the three merging corporations. Prior to the merger and consolidation one of the corporations had issued bonds at a discount. In the taxable year petitioner called and redeemed some
61 of these bonds. Held, petitioner is entitled to take as a dededuction in the taxable year the unamortized discount and expenses applicable to such bonds redeemed.

Francis J. Sweeney, Esq., for the petitioner.

Chester A. Gwinn, Esq., for the respondent.

This proceeding involves deficiencies in income taxes of $101,395.24 for 1927 and $320,017.64 for 1928.

The petition assigns numerous errors, but all of these have been setiled by agreement except certain issues which have been stated in a stipulation filed at the hearing by the parties. The issues which remain for our decision are stated in the stipulation, as follows:

(A) Whether respondent erred in refusing to allow as a deduction from petitioner's gross income in 1927 the sum of $551,742.90, composed of $243,645.00, representing the amount of premiums accrued and paid by the petitioner in said year upon the retirement of $3,250,000 face value of Metropolitan Power Company First Mortgage Gold Bonds, Series A, due in 1953, and $308,097.90, representing the amount of unamortized discount and expense on said bonds at the time they were retired in 1927?

(B) Whether the respondent erred in refusing to allow as a deduction from petitioner's gross income in 1928 the sum of $2,455,855.85 after deduction of $60,811.86 from $2,516,667.71 composed of $607,978.14, representing the amount of premium paid by the petitioner in said year upon the retirement of $6,080,000 of its First and Refunding Gold Bonds, Series B, due in 1952, $489,167.15 representing the amount of unamortized discount and expense on said bonds at the time they were retired in 1928, and $645,251.34, representing premiums paid and $774,271.08, representing unamortized debt discount and expense, pertaining to the other bonds hereinbefore recited which were retired in 1928? All other issues raised by the pleadings
62 have been settled by agreement of the parties, and the result of such settlement is reflected in the following stipulations as to the amounts of the deficiencies, to-wit:

(a) If both issues (A & B) are decided in favor of the respondent, the amounts of the deficiencies are (1927) $54,549.21, (1928) $283,025.50.

(b) If both issues are decided in favor of the petitioner, the amounts of the overpayments are (1927) $19,936.08, (1928) $11,677.20. If the Board's decision is otherwise than indicated in paragraphs (a) and (b), supra, the amount of the deficiencies or overpayments should be determined under Board Rule 50.

Findings of fact

The facts have been embodied in a stipulation, together with certain exhibits attached thereto. These are adopted as our findings of fact. The stipulation of facts will be embodied as a part of this report, but the exhibits therein referred to, some of which are quite lengthy, will be omitted because it is not deemed necessary to copy them in this report.

The stipulation of facts is as follows:

1. The petitioner, Metropolitan Edison Company, a corporation duly organized and existing under the laws of the State of Pennsylvania, is and was at all times material to this proceeding, engaged in the business of supplying electric light and power in the Cities of Reading and Lebanon, Pennsylvania, and extensive surrounding territory. The petitioner, through affiliated subsidiaries, also operates a unified system of electric properties, which serve Easton, York, York Haven, Hanover, Gettysburg, and adjacent communities in Pennsylvania and Northern Maryland, embracing 184 communities, besides 123 boroughs and towns where power is wholesaled to local distributing companies, serving a population of about 662,000 with 508 miles of high tension transmission lines and 703 miles of distribution lines, a large portion of those in the City of Reading being in underground conduits.

63 2. The petitioner, with its affiliated taxpayers, filed consolidated returns for the calendar years 1927 and 1928. A list of the affiliated taxpayers appears on pages 1, 2, and 3 of the notice of deficiency, being Exhibit A attached to the petition.

3. Metropolitan Power Company (hereinafter called Power Co.) was organized under the laws of Pennsylvania, on April 24, 1923. All its stock was owned by the petitioner. On or about July 17, 1923, the Power Co. assumed, with the sanction of the Pennsylvania Public Service Commission, the legal status of a public service company with all the obligations imposed upon it by such status, and upon its written stipulation that the Certificate of Public Convenience may be limited to the erection, operation, and maintenance of a plant and proper associated facilities for the manufacture of electric energy in and adjoining the Borough of Middletown, Dauphin County, Pennsylvania, and for the distribution and sale at said plant, and not elsewhere, of electrical energy. The purpose of the Power Co. was to build and operate a large electric generating station on the Sus-

quehanna River, embracing a tract of about 62½ acres in the Borou of Middletown, an advantageous location for its power plant. A the electricity generated at the station was sold to the petitio pursuant to a contract whereby the petitioner agreed to pay there a total amount sufficient to enable the Power Co. to earn a gr revenue at least sufficient to meet all costs of operation and ot charges, other than for capital purposes, including maintenan depreciation, taxes, and interest on indebtedness.

4. The Power Co. was organized as a separate corporation in or to be able to raise a large part of the necessary construction fu through a first lien mortgage on the plant. The petitioner, in 19 purchased and guaranteed and sold to the public, all of the bo issued by the Power Co.; purchased all of the stock and loaned the Power Co. on open account approximately $3,000,000 and, exc for the $3,250,000 of bonds, the petitioner was practically the s investor and creditor. These bonds were originally issued
64 90 to the petitioner, which immediately endorsed them a guaranteed them as to principal and interest and sold th at the same price.

5. On February 15, 1927, the Public Service Commission of t State of Pennsylvania issued its Certificate of Public Convenie granting the application of the Power Co. for approval of the s of all its property except public franchises to the petitioner. (T petition specifically states that the Power Co. had no public fr chises; and for that reason a sale was resorted to rather than merger.) The actual transfer, according to the books, took pl on February 28, 1927. All its assets and liabilities were transfer to the books of the petitioner as they stood on the books of the Po Co. The deficit from operations was charged against the surp of the petitioner. The petitioner surrendered the entire capital st of the Power Co. to it for cancellation and the company beca inactive on or about February 28, 1927, and continued inactive u its dissolution on or about January 8, 1928.

6. The petitioner, on February 28, 1927, assumed the $3,250,0 liability of the Power Co.'s First Mortgage Gold Bonds, Series 6% due June 1, 1953, which, as stated supra, were guaranteed by at issuance, of which the entire amount was outstanding in the ha of nonaffiliated parties. The inter-corporate debt of the Power C to the petitioner was cancelled in the amount of approximat $3,000,000.

7. The bonds assumed were callable on thirty days' published not on any interest date to and including June 1, 1938, at 107½%; a pursuant to the terms of the indenture the bonds were called f redemption on December 1, 1927, by the petitioner, which purcha or redeemed and then retired during the calendar year 1927 t following First Mortgage Gold Bonds, Series A 6% due 1953 of t Power Co., as follows:

65 Date purchased and/or redeemed *	Principal amount	Price	Accrued and paid premium
October 21, 1927	$1,000	$107.125	$71.22
October 21, 1927	5,000	107.25	362.50
November 11, 1927	27,000	107.375	1,991.25
November 17, 1927	1,000	107.50	75.00
November 21, 1927	25,000	107.375	1,843.75
November 21, 1927	17,000	107.50	1,275.00
November 27, 1927	19,000	107.375	1,401.25
December 1, 1927 *	$3,155,000	107.50	236,625.00
Total	$3,250,000		$243,645.00

8. At the time of the redemption of said bonds, as aforesaid, there remained of the debt discount and expense incurred on the issuance of said bonds $308,097.90, unamortized by annual deductions. Petitioner now claims the right to deduct from its gross income for 1927 premiums accrued and paid in 1927, amounting to $243,645.00 and said unamortized debt discount and expense, or a total of $551,742.90.

9. There are attached hereto and made a part hereof: Exhibit A, Certificate of the Secretary of the Public Service Commission of the Commonwealth of Pennsylvania dated February 25, 1927; Exhibit B, Certificate of Public Convenience dated February 15, 1927; Exhibit C, Report and Order of the Public Service Commission dated February 15, 1927; Exhibit D, Application of the Power Co. for Certificate of Public Convenience; Exhibit E, letter dated February 4, 1927, from Hedley V. Cooke to the Secretary of the Public Service Commission in reply to Exhibit F, the Public Service Commission's letter of January 31, 1927.

10. On or about June 9, 1927, the petitioner sold 28,000 shares of its common capital stock for $1,540,000, and on November 29, 1927, it borrowed from General Gas & Electric Corporation on a demand note $1,700,000, which funds were employed to retire the aforesaid First Mortgage 6% Bonds issued by the Power Co., guaranteed both as to principal and interest by petitioner at the time of issue and assumed upon the acquisition of the assets of the Power Co. in February, 1927.

66 11. On February 1, 1928, the petitioner, pursuant to previous notice and call, as required by the Indenture, retired bonds of the principal amount of 6,080,000 (being all of the bonds outstanding) of its First and Refunding Mortgage Gold Bonds, Series B, 6% issued February 1, 1922, and maturing February 1, 1952. Upon said retirement, the petitioner paid in cash a premium of $607,978.14, which thereupon accrued. The premium or call price was $110. A small amount of the bonds were purchased during the calendar year 1928 for retirement before the actual retirement date at slightly less than $110. This explains why the premium accrued and paid is as above stated, rather than $608,700. The amount of unamortized discount and expense on said bonds at the time of their retirement in 1928 was $489,167.15. Petitioner claims these amounts as deductions from income in 1928. The total premiums and unamortized

debt discount and expense at the time of retirement incurred and accrued during the calendar year 1928 upon the aforesaid retirement, amounted to the sum of $1,097,145.29. The object of the company in retiring these bonds was to reduce its interest expense rate from 6% to 4½% and to simplify the corporate funded debt structure. The retirement was accomplished by funds which were borrowed on a short term note to the Guaranty Trust Company, which loan was repaid from the proceeds of petitioner's issue of $23,000,000 First Mortgage 4½% Gold Bonds, Series D, issued March 1, 1928, due in 1968.

12. During the calendar year 1928 the petitioner pursuant to the terms of the various indentures hereinafter referred to, called and retired the following obligations of former subsidiaries which it theretofore had assumed by merger under the Laws of Pennsylvania, as more particularly said hereinafter. In retiring these assumed obligations, the petitioner incurred and paid premiums as follows:

67 Description of the obligation assumed by the petitioner upon merger	Principal retired	Premium incurred and paid
Cumberland Valley Light & Power Co. 1st Mtg. 6's 1951	$30,400.00	912.0
York Haven Water & Power Co. 5's due 1957	$1,345,000.00	$66,905.0
Hanover Power Co. 1st Mtg. 6's Series A 6/1/28 Series B & C due 1941	807,200.00	12,492.5
Metropolitan Electric Co. 1st Mtg. 5's due 1939	2,348,000.00	234,425.0
Pennsylvania Edison Co. 1st A 5's B 6's Mtg. 1946 (See note A)	6,612,300.00	330,520.0
Total Premiums Incurred and Paid on Retirement		$645,251.5

At the time the aforesaid obligations were redeemed and retired there existed unamortized debt discount and expense amounting to $769,864.54 and consisted of:

Description of the obligation assumed by the petitioner upon merger	Unamortized debt discount and expense at retirement
Cumberland Valley Light & Power Co. 1st Mtg. 6's 1951	$9,736.0
York Haven Water & Power Co. 5's due 1957 Advertising Notice of Redemption	171.0
Hanover Power Co. 1st Mtg. 6's Series A due 6/1/28 series B & C due 1941	50,215.5
Metropolitan Electric Co. 1st Mtg. 5's 1939	17,363.2
Pennsylvania Edison Co. 1st Mtg. A 5's B 6's 1946 (See Note A)	692,376.9
Total Unamortized Debt Discount and Expense incurred at retirement	$769,864.5

NOTE A.—Pennsylvania Utilities Co. and Pennsylvania Edison Co. merged in 1921 see Exhibit K. Prior to the merger Pennsylvania Utilities Co. had issued $1,715,300.00 of said bonds while Pennsylvania Edison Co. issued $4,797,100.00 of said bonds subsequent to said merger in 1921.

68 Petitioner claims the right to deduct the aforesaid items of bond discount and expense and premiums from its gross income for 1928.

13. The obligations under the Indentures were prior liens upon assets acquired at the time the aforesaid companies were merged with the petitioner pursuant to the laws of the Commonwealth of Pennsylvania. At the time of the merger of each of the aforesaid

companies, the assets and liabilities were acquired and transferred by merger and the liabilities thus assumed, as shown in Exhibits G, H, I, J, and K, being the applications to the Public Service Commission of Pennsylvania for approval of the plans of merger and consolidation. The mergers of all of the aforesaid companies were under the act of the General Assembly of the Commonwealth of Pennsylvania April 17, 1876 P. L. 33 and the amendments thereof and supplements thereto except Metropolitan Electric Company which was merged pursuant to Act of May 3, 1909 P. L. 408, Sec. 1 and Pennsylvania Edison Company which was merged under Section 23 of the General Corporation Act of April 29, 1874 P. L. 30 as amended by Section 1 of the Act of April 2, 1915, P. L. 724, and all the mergers aforesaid were upon application with the approval and sanction of the Public Service Commission of the Commonwealth of Pennsylvania under Section 3 (c), Article III and Sections 18 and 19, Article V of the Public Service Company Law with the issuance of a report, order, and certificate of public convenience.

14. On April 1, 1928 pursuant to the terms of the Indenture Hamburg Gas and Electric Company retired the following obligations at par:

$58,500 principal amount First Mortgage and Refunding 5% Gold Bonds issued October 1, 1913 due October 1, 1933.

$48,000 principal amount First Mortgage 5% Gold Bonds issued 1919 due April 1, 1930.

The amount of $4,395.04 represented the unamortized debt discount and expense remaining at the time the bonds were retired, of which 91.2% is applicable to the issue of October 1913 and 8.8% is applicable to the issue of 1910. Petitioner claims said amount as a deduction from income in 1928 consolidation.

69 15. On May 1, 1928, pursuant to the terms of the Indenture, Topton Electric Light and Power Company retired, at par $30,000, principal amount First Mortgage 5% Twenty Year Gold Bonds issued November 1, 1918, due November 1, 1938. At the time of the retirement there existed unamortized discount and expense in the amount of $4.65 which petitioner claims as a deduction in 1928 consolidation.

16. On April 1, 1928, pursuant to the terms of the Indenture, Blue Mountain Electric Company retired, at par, $30,000, First Mortgage 6% Twenty Year Gold Bonds issued April 1, 1921, due April 1, 1941. At the time of the retirement there was incurred and paid, satisfaction fees and expense on said issue in the amount of $6.85 which amount petitioner claims as a deduction in 1928 consolidation.

17. The aforesaid companies (named in paragraphs 14, 15, and 16, supra) became affiliated with the petitioner through the purchase by the latter of their capital stock on April 1, 1928. They were merged with the petitioner on June 30, 1928. The aforesaid retirement of bonds of said companies occurred coincident with the acquisition of

their stock by the petitioner on April 1, 1928, except as stated in paragraph 15 and was effected with funds advanced by the petitioner.

18. Except in the cases as hereinbefore stated where it was obtained through sale of common stock by the petitioner and loans made by the petitioner from General Gas & Electric Corporation and Guaranty Trust Company, the money necessary to carry out the foregoing retirements was obtained from the proceeds of the sale on March 1, 1928, of $23,000,000 of Metropolitan Edison Company's First Mortgage 4½% Gold Bond Series D due March 1, 1968. The premiums, expense, and unamortized debt discount and expense are claimed by the several taxpayers as proper deductions in arriving at the consolidated taxable net income.

19. The respondent has allowed a deduction of $60,811.86 from the petitioner's gross income in 1928, which amount represents an aliquot part of the entire amount of premiums, discount, and expense
70 incident to the retirement of the Power Company's First Mortgage 6% Bonds (due 1953), petitioner's First and Refunding Bonds (due 1952), and the other bonds hereinbefore recited, in said year, as though the same were a part of the discount and expense applicable to petitioner's issue in 1928 of $23,000,000 First Mortgage 4½% Gold Bonds, Series D, due March 1, 1968. The additional deduction claimed by petitioner for 1928 on account of bond premiums, discount, and expense is $2,455,855.85, being the difference between the amount of $2,516,667.71 claimed by the petitioner and $60,811.86 allowed by the respondent.

Opinion

BLACK: The issues which remain for our decision have been set out in our preliminary statement. We think, however, that these issues will be better understood if we subdivide them somewhat and this we shall do.

I

Bond premiums and unamortized discount and expense, relating to redemption of petitioner's own bonds.—We shall first take up petitioner's claim for deduction of $1,097,145.29, being the total premiums and unamortized debt discount and expense incurred and accrued at the time of the retirement of $6,080,000 of petitioner's own bonds in 1928. The facts with reference to the retirement of these bonds are stated in paragraph 11 of the stipulation.

The only contention which respondent makes as to why petitioner is not entitled to the deduction claimed is that the bonds were redeemed with the proceeds of petitioner's new bond issue of $23,000,000 first mortgage 4½ percent gold bonds, series D, issued March 1, 1928, due in 1968, and that the amount claimed should be amortized over the life of these new bonds.

It will be noted that none of petitioner's old bonds redeemed
71 in 1928 were exchanged for bonds of the new issue. The bonds retired were redeemed in cash. Under these circum-

stances petitioner is entitled to the deduction claimed. American Gas & Electric Co., 33 B. T. A. 471; East Ninth Euclid Co., 26 B. T. A. 32; 27 B. T. A. 1289; National Tile Co., 30 B. T. A. 32; San Joaquin Light & Power Co. v. McLaughlin, 65 Fed. (2d) 677; Commissioner v. Columbia Steel Corporation, 67 Fed. (2d) 989; Commissioner v. California-Oregon Power Co., 75 Fed. (2d) 644; Commissioner v. Union Public Service Co., 75 Fed. (2d) 723; Commissioner v. Central States Electric Corporation, 76 Fed. (2d) 1011.

The respondent in his brief admits that the foregoing authorities are against him on this point, but elects not to concede the issue.

II

Unamortized discount and expense of redemption relating to subsidiaries' bonds.—We shall next take up petitioner's claim for deduction on a consolidated return for 1928 of unamortized discount and expense relating to certain bond issues of the Hamburg Gas & Electric Co., Topton Electric Light & Power Co., and Blue Mountain Electric Co.

These corporations were subsidiaries of petitioner and filed consolidated returns with petitioner for the year 1928. The facts with reference to the retirement of these bonds are stated in paragraphs 14, 15, 16, and 17 of the stipulation. These bonds were redeemed by the corporations which issued them with funds advanced by petitioner. Respondent's only contention as to why petitioner is not entitled to take the deduction claimed on the consolidated return is that the funds with which the bonds were redeemed were obtained by petitioner's new issue of $23,000,000 of bonds discussed under I above. Respondent admits that the authorities are against
72 him on this point, but he does not concede the issue. On the strength of the authorities cited under I above, we hold for petitioner on this issue.

III

Bond premiums incurred and paid in redemption of bonds assumed by petitioner in acquiring assets of subsidiary corporations.—We shall next consider petitioner's contention that it is entitled to deduct bond premiums incurred and paid in the redemption of bonds which were not originally issued by petitioner but which it assumed and agreed to pay at the time it acquired all the assets of certain of its subsidiaries. The circumstances attending the assumption of and agreement to pay these several bond issues and the names of the subsidiaries are set forth in the stipulation and need not be repeated here. We deem it unimportant to decide for this point whether petitioner became liable to pay these bonds as a part of the consideration for the purchase of assets in liquidation of a subsidiary or whether the transaction in which the bonds were assumed was a nontaxable reorganization between petitioner and its subsidiary short

of a statutory merger and consolidation, or whether the transaction by which petitioner became liable on the bonds was a statutory merger and consolidation of two or more corporations under which petitioner as the succeeding consolidated corporation became liable on the bonds not by reason of a contract or purchase, but by operation of law. We think in any event, regardless of the form of the transaction, petitioner is entitled to the deduction of the premiums which it paid in the redemption of these bonds. When petitioner became liable to pay the bonds, whether by contract of purchase and assumption, or by contract of merger short of a statutory consolidation, or by operation of law following a statutory merger and
73 consolidation of corporations under the laws of the State of Pennsylvania, it became definitely and legally liable for only the face value of the bonds plus the rate of interest provided in the bonds. The bonds, it is true, contained provisions by which the obligor could declare the premature maturity of the bonds upon condition that certain premiums would be paid upon redemption.

This redeption would usually occur only were prevailing interest rates would justify the calling of the bonds and incurring a premium, so that the debt represented by the bonds could be refunded at a lower interest rate. We do not think that the expenses incurred in redeeming bonds at a premium under such circumstances represent any part of the cost of the assets taken over when liability to pay the face value of the bonds was incurred. Therefore, to say, as respondent contends, that a taxpayer under such circumstances is not entitled to a deduction for the amount of bond premiums incurred in the redemption of bonds, unless he affirmatively shows that he has incurred a loss in the purchase of the assets equal to the amount of the bond premiums paid, is not correct reasoning, we think.

Such, it is true, was the basis of our reasoning in Coast Counties Gas & Electric Co., 33 B. T. A. 1199, but we now think that was error. In that case certain subsidiaries of the Coast Counties Gas & Electric Co., under agreements executed and carried out several years prior to the taxable year in question, transferred their properties to the parent corporation, which, as part of the consideration for such transfers, agreed to pay the bonds of the subsidiaries. In 1930 the bonds were called and retired. The taxpayer, the parent corporation, paid a premium upon some of the bonds. We held that the taxpayer might not deduct the amount of said premium, as there was no showing that it sustained a loss on the transaction.
74 We cited in support of our holding in that respect, Helvering v. American Chicle Co., 291 U. S. 426, and United States v. Kirby Lumber Co., 284 U. S. 1. We distinguished Bowers v. Kerbaugh Empire Co., 271 U. S. 170. On reconsideration we think these cases are not in point. In Helvering v. American Chicle Co., supra, the taxpayer in a purchase of assets had assumed and agreed to pay as a part of the purchase price of the assets taken over, the full face value of the seller's outstanding bonds. Subsequently it purchased some of these bonds at less than their issuing price. The Commis-

sioner determined that the difference between the issuing price of the bonds and the price at which they were purchased represented income to the American Chicle Co. The Supreme Court upheld this contention of the Commissioner, citing United States v. Kirby Lumber Co., supra. The Supreme Court, as a part of its reasoning, said: "Nothing indicates whether respondent lost or gained by the transaction. * * * Here, for aught we know, there was substantial profit—certainly the record does not show the contrary. Doubtless respondent's books indicated a decrease of liabilities with corresponding increase of net assets."

As we have already pointed out, we do not think that bond premiums paid in the redemption of bonds represent a part of the cost of assets taken over. Rather we think they represent part of the expenses of taxpayer's business and are deductible as ordinary and necessary business expenses under the provisions of section 23 (a) of the Revenue Act of 1928, and section 214 (a) of the Revenue Act of 1926, which are applicable to the taxable years involved in this proceeding.

But if we are wrong in characterizing such bond premiums as ordinary and necessary business expenses, such premiums would be deductible under the loss provisions of the applicable statutes. The Court of Claims in the recent case of American Gas & Electric
75 Co. v. United States, 17 Fed. Supp. 151, held, under facts practically the same as those present here, that the corporation, which had assumed and agreed to pay the bonds when it took over the assets of the selling corporation and subsequently called the bonds for redemption at a premium, was entitled to take as a loss deduction the amount of the premiums paid in the year of redemption. It will be thus noted that in the American Gas & Electric Co. case the Court of Claims placed the allowable deduction under the loss provisions of the statute. So it seems plain that whether the amount of bond premiums paid under such circumstances is characterized as business expense or as a loss, it is an allowable deduction in determining taxpayer's net income.

We now think that our holding in the Coast Counties Gas & Electric Co. case, supra, to the contrary was erroneous and on that point it will no longer be followed.

IV

Unamortized discount and expense relating to bonds of the Metropolitan Power Co.—We shall next consider petitioner's claim of the right to deduct unamortized discount and expenses on its consolidated return for 1927 by reason of its redemption in that year of certain bonds previously issued by the Metropolitan Power Co. The amount of the deduction claimed in this respect is $308,097.90. Facts with reference to these bonds are shown in paragraphs 3, 4, 5, 6, 7, 8, 9, and 10 of the stipulation.

Petitioner does not contend that the transaction by which petitioner took over the assets of the Metropolitan Power Co. and assumed all

of its outstanding liabilities, including the bonds in question, was a strict merger under the laws of the State of Pennsylvania. Pe-
76 titioner in its brief terms the transaction as a de facto merger. Regardless of petitioner's characterization, we think the facts which have been stipulated show a liquidation of the Metropolitan Power Co. by its parent, the Metropolitan Edison Co. Such a liquidation is one in which gain or loss is recognized to the parent corporation. Pierce Oil Corporation, 32 B. T. A. 403; Commissioner v. Aluminum Goods Manufacturing Co., 287 U. S. 544; Commissioner v. Riggs National Bank, 57 Fed. (2d) 980. In such a transaction the purchasing corporation is not entitled to deduct the unamortized discount and expenses remaining unrecovered on the bonds previously issued by the subsidiary. Turner-Farber Love Co. v. Commissioner, 68 Fed. (2d) 416; American Gas & Electric Co., 33 B. T. A. 471; affirmed, except as to bonds of Appalachian Power Co., which the court held to have been assumed in a statutory merger or consolidation; American Gas & Electric Co. v. Commissioner, 85 Fed. (2d) 527.

Following these authorities we hold that petitioner is not entitled to the deduction of $308,097.90 unamortized discount and expenses which it claims by reason of the redemption in 1927 of bonds of the Metropolitan Power Co.

V

Unamortized discount and expense relating to bonds assumed by petitioner upon transfer of assets by wholly owned subsidiaries in a so-called "short form" of merger.—We shall next take up petitioner's claim for deduction on a consolidated return for 1928 of $769,864.54 unamortized debt discount and expense of retirement of bonds previously issued by the Cumberland Valley Light & Power Co., York Haven Water & Power Co., Hanover Power Co., and Pennsylvania Edison Co. Facts with reference to these bonds will be found in paragraphs 12 and 13 of the stipulation.

It has been stipulated that during the calendar year 1928 the
77 petitioner, pursuant to the terms of the various indentures referred to, called and retired certain bonds of former subsidiaries which it theretofore had assumed by merger under the laws of the State of Pennsylvania. It has also been stipulated that the four so-called mergers above referred to were under the acts of the General Assembly of the Commonwealth of Pennsylvania of April 29, 1874, and April 17, 1876.

The two acts of April 29, 1874, and April 17, 1876, pursuant to which the contracts were executed, and amendments thereto are embodied in 15 Purdon's Pennsylvania Statutes, Annotated, section 595, and the following provisions are pertinent to this controversy:

"Any corporation created under the provisions of this act, * * * may reduce its capital stock * * * by a vote of the stockholders * * *; and it shall be lawful for any corporation in the same manner to sell, assign, dispose of, and convey to any corporation

created under or accepting the provisions of this act, its franchises, and all its property, real, personal, and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid * * *."

We think that the so-called mergers under the above quoted acts, which petitioner in its brief calls "short form of merger," amounted in effect to a sale by the subsidiary of its assets to the parent corporation. In fact in each of the exhibits attached to the stipulation, showing details of the merger of Cumberland Valley Light & Power Co., York Haven Water & Power Co., Hanover Power Co., and Pennsylvania Edison Co. with the Metropolitan Edison Co., petitioner, the transaction is referred to as a sale of assets by the subsidiary to the parent corporation. For example, in the application for approval by the Public Service Commission of the Commonwealth of Pennsylvania of the transfer of assets by the York Haven Water & Power
78 Co. to the Metropolitan Edison Co., the proceeding is captioned as follows: "In the Matter of the application of York Haven Water and Power Company and Metropolitan Edison Company under Section 3 (c) Article III and Sections 18 and 19, Article V of the Public Service Company Law, for the approval of the sale of the property and franchises of the former to the latter Company." A careful inspection of each of the exhibits which show the details of the transfer of assets by the four above named corporations to the Metropolitan Edison Co. convinces us that the transactions were essentially liquidations of those companies in consideration of the surrender and cancellation of all their capital stock which was held by petitioner and the assumption of all their liabilities by the petitioner.

In such a situation the same rule applies as we applied in IV above, relating to the bonds of Metropolitan Power Co. On the strength of the authorities there cited, we hold against petitioner on the issue of deduction of unamortized discount and expense on the redemption of the bonds of the Cumberland Valley Light & Power Co., York Haven Water & Power Co., Hanover Power Co., and Pennsylvania Edison Co.

VI

Unamortized discount and expense bonds assumed by petitioner in consolidation of three corporations to form petitioner.—On August 6, 1917, the following corporations were consolidated to form the Metropolitan Edison Co. (petitioner): Metropolitan Electric Co., Edison Electric Illuminating Co. of Lebanon, Pennsylvania, and Lebanon Valley Electric Light Co. This consolidation took place under the Act of May 3, 1909, P. L. 408, section 1, Laws of the State of Pennsylvania. See paragraph 13 of the stipulation.

Section 5750 of the Pennsylvania Statutes, which amends the act of May 3, 1909, reads as follows:
79 "SEC. 5750. Effect of merger; new patent bonus; certificate of reports and payment of taxes.—Upon the filing of said

certificates and agreement, or copy of the agreement, in the o
of the Secretary of the Commonwealth, and upon the issuing of
letters patent thereon by the Governor, the said merger shall
deemed to have taken place, and the said corporations to be
corporation under the name adopted in and by said agreem
possessing all the rights, privileges, and franchises theretofore ve
in each of them; and all the estate and property, real and perso
and rights of action, of each of said corporations, shall be dee
and taken to be transferred to and vested in the said new corporati
without any further act or deed: Provided, That all rights of cr
itors and all liens upon the property of each of said corporati
shall continue unimpaired, limited in lien to the property affec
by such liens at the time of the creation of the same, and the resp
tive constituent corporations may be deemed to be in existence
preserve the same; and all debts not of record, duties, and liabili
of each of said constituent corporations shall thenceforth attach
the said new corporation, and may be enforced against it to the sa
extent and by the same process as if said debts, duties, and liabili
had been contracted by it. But such merger and consolidation sh
not be complete, and no such consolidated corporation shall do a
business of any kind, until it shall have first obtained from
Governor of the Commonwealth new letters patent, and shall ha
paid to the State Treasurer a bonus, as prescribed by law, upon
its capital stock in excess of the amount of capital stock of t
several corporations so consolidating, upon which the bonus requi
by law has been theretofore paid: And provided further, That n
letters patent of such consolidated corporation shall not be issued
the Governor of the Commonwealth, until each corporation enteri
into and forming the consolidated corporation shall have filed w
the Secretary of the Commonwealth a certificate from the Audit
General of the Commonwealth, setting forth that all reports requi
by the Auditor General of the Commonwealth have been du
80 filed to the date of the proposed merger, and that all taxes d
the Commonwealth of Pennsylvania have been paid, up to a
including said date." (1915, April 20; P. L. 205, sec. 1.)

The agreement of merger is set out in full in Exhibit J of t
stipulation and bears the caption, "Agreement of Consolidation a
merger by and between Metropolitan Electric Company, The Edis
Electric Illuminating Company of Lebanon, Pa., and Lebanon Vall
Electric Light Company Forming Metropolitan Edison Company
The agreement to merge and consolidate is a lengthy document a
it is believed unnecessary to set it out in full here. Suffice it to s
it appears to follow and comply with the Pennsylvania Act of M
3, 1909, as amended, relating to mergers and consolidation of Pen
sylvania corporations.

We are of the opinion that the merger and consolidation of t
three named corporations to form the petitioner—Metropolitan Ed
son Co.—was substantially the same as the mergers involved
Connecticut Electric Service Co., 35 B. T. A. 444. In that case

upheld the contention of the taxpayer that the corporation, which assumed and agreed to pay the bonds of its merged subsidiary as a part of the plan of the merger, was entitled to succeed to the right to deduct unamortized discount of the bond issue of the subsidiaries. In ruling upon this point, we said:

"Three courts and this Board have now spoken on the right of a corporation resulting from a statutory merger to deduct bond discount on bonds issued by a constituent corporation, and they have all reached the same result in allowing such deduction. The Circuit Court of Appeals for the Fourth Circuit, in Western Maryland Ry. Co. v. Commissioner, 33 Fed. (2d) 695; the Circuit Court of Appeals for the Second Circuit, in New York Central R. R. Co. v. Commissioner, 79 Fed. (2d) 247, and American Gas & Electric Co. v. Commissioner, 85 Fed. (2d) 527; the Court of Claims, in American
81 Gas & Electric Co. v. Commissioner, — Fed. Supp. — (Dec. 7, 1936); and this Board in Illinois Power & Light Corporation v. Commissioner, 33 B. T. A. 1189, all allowed the deduction where the consolidation or merger was effected pursuant to the provisions of state statutes." Turner-Farber-Love Co. v. Commissioner, 68 Fed. (2d) 416, did not involve a statutory merger.

On the strength of Connecticut Electric Service Co., supra, and cases there cited, we hold that petitioner is entitled to deduct $17,383.28 unamortized debt discount and expenses upon retirement in 1928 of bonds of the Metropolitan Electric Co. We do not regard this holding as being in conflict with Pennsylvania Co. for Insurances on Lives and Granting Annuities v. Commissioner, 75 Fed. (2d) 719. That case involved the right of a consolidated corporation resulting from the merger and consolidation of two other Pennsylvania corporations to bring forward the statutory net loss of one of the merging corporations incurred in the period prior to the merger and use it as a deduction from the income of the corporation resulting from the consolidation. The court denied the right claimed, citing as authority New Colonial Ice Co. v. Helvering, 292 U. S. 435.

We have here no question of the right to carry forward and use as a deduction a statutory net loss. If the same rule that governs the carrying forward of statutory net losses applies to unamortized discount on bonds, then our decision in Connecticut Electric Service Co., supra, was wrong and so would be all the cases cited in that report in support of the conclusion there reached. We do not think the rule applicable to the carrying forward of statutory net losses is applicable here.

Reviewed by the Board.

Decision will be entered under Rule 50.

82 STERNHAGEN, dissenting: It seems to me that the decision in subdivision VI, allowing the deduction of $17,383.28 unamortized discount and expense upon the retirement in 1928 of the bonds of the Metropolitan Electric Co., is contrary to Turner-Farber Love Co. v. Commissioner, 68 Fed. (2d) 416; American Gas & Elec-

tric Co. v. Commissioner, 85 Fed. (2d) 527. The petitioner is, under Pennsylvania law, "an entity entirely distinct from that of its constituents," and as the result of merger or consolidation, the constituent corporations "are deemed dissolved" and "cease to exist." Pennsylvania Co. for Insurances, etc., v. Commissioner, 75 Fed. (2d) 719. In this important respect the situation is different from a consolidation in Connecticut, and Connecticut Electric Service Co., 35 B. T. A. 444, is not controlling. There the Board said that "the law of Connecticut is particularly clear in providing that the constituent corporations in the case of a merger or consolidation continue their existence in the corporations into which they are merged and consolidated."

MURDOCK agrees with this dissent.

SMITH, dissenting: I am of the opinion that the petitioner is entitled to deduct from the gross income of the taxable years the amounts which have been disallowed in the prevailing opinion of the Board as deductions for unamortized bond discount and expense. The petitioner took over its subsidiaries under mergers of the petitioner with its subsidiaries. It took over the assets of its subsidiaries at the actual costs to the subsidiaries. If the petitioner is not entitled to deduct the unamortized bond discount and expense upon the bonds redeemed in the taxable years it will never get deductions for the unamortized bond discount and expense upon the bond
83 issues of the subsidiaries. In my opinion such a result is not responsive to the legislative intent. See Western Maryland Ry. Co. v. Commissioner, 33 Fed. (2d) 695; New York Central R. Co. v. Commissioner, 79 Fed. (2d) 247.

MORRIS, dissenting: I dissent from that part of the opinion which is inconsistent with the Coast Counties Gas & Electric Co., 33 B. T. A. 1199, for the reasons given in that opinion in support of the conclusion therein.

Before United States Board of Tax Appeals

Decision

Entered July 2, 1937

Pursuant to the findings of fact and opinion of the Board promulgated May 14, 1937, and motion filed by respondent on June 30, 1937, together with a notice of settlement agreed thereto by petitioner, now, therefore, it is

Ordered and decided that there are deficiencies in income tax for the years 1927 and 1928 in the respective amounts of $21,657.13 and $78,620.55.

(Sgd.) EUGENE BLACK, *Member.*

84 In United States Circuit Court of Appeals for the Third Circuit

[Title omitted.]

Petition to review decision of the United States Board of Tax Appeals

Filed September 29, 1937

To the Honorable the Judges of the United States Circuit Court of Appeals for the Third Circuit:

Now comes the petitioner, Metropolitan Edison Company, a corporation organized and existing under the laws of the Commonwealth of Pennsylvania (hereinafter referred to as the petitioner) by its undersigned attorneys, and respectively shows to the Court as follows:

I. Jurisdiction for Review

This is a proceeding for review by the United States Circuit Court of Appeals for the Third Circuit of so much of the decision of the United States Board of Tax Appeals, entered on the second day of July 1937, Docket No. 57869 (affirming in part and redetermining the deficiencies in income tax theretofore determined by the Commissioner of Internal Revenue (hereinafter referred to as the
85 Commissioner) for the calendar years 1927 and 1928 (as determines that there are deficiencies in income tax for said years 1927 and 1928.

The petitioner is a corporation duly organized and existing under the laws of the Commonwealth of Pennsylvania, with its principal place of business at the City of Reading in said Commonwealth.

The Commissioner, the respondent on review, is the duly appointed, qualified, and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States of America.

The petitioner filed its income-tax returns for the calendar years 1927 and 1928, respectively, with the Collector of Internal Revenue for the first district of Pennsylvania at Philadelphia, Pennsylvania, which is within the judicial circuit of the United States Circuit Court of Appeals for the Third Circuit, in which court review of the said decision of the Board of Tax Appeals is sought by the petitioner.

II. The Nature of the Controversy

On March 11, 1931, the Commissioner mailed to the petitioner a notice of deficiency in income tax for the calendar years 1927 and 1928 in the amounts of $249,422.80 and $407,285.21, respectively. Thereafter, the petitioner duly filed its petition for the redetermination of the said asserted deficiencies with the United States Board of Tax Appeals (hereinafter referred to as the Board). The Com-

missioner duly filed his answer to the said petition and trial was
on the issues raised by said petition and answer. On May 14,
the Board promulgated its report and opinion and on the second
of July 1937, entered its final decision redetermining the deficie
in the amount of $21,657.13 for the calendar year 1937, and in
amount of $78,620.55 for the calendar year 1938.

86 III. The Matters in Controversy

The facts are contained in a stipulation (recited in full in
Board's opinion and adopted as its findings of fact) and cer
exhibits annexed thereto. The sole matters for decision in the
troversy are whether the petitioner is entitled to deductions
respect to unamortized discount and expense (a) applicable to b
of Metropolitan Power Company, a former subsidiary of the
tioner, which were assumed by it upon a transfer of the assets of
Metropolitan Power Company to it and which were subsequently
deemed and retired by the petitioner, and (b) applicable to bond
three former subsidiaries of the petitioner whose assets were tr
ferred to it pursuant to the provisions of the so-called "short for
merger" statute of Pennsylvania, which bonds were subseque
redeemed and retired by the petitioner.

(a) In 1923 Metropolitan Power Company was organized
wholly owned subsidiary of the petitioner for the purpose of buil
and operating an electric generating station and of raising a l
part of the necessary construction funds through a first mort
thereon. It had no public franchises and sold all of the power
erated to the petitioner for an amount sufficient to carry opera
expenses and fixed charges, particularly on the debt, the disco
and expense of which are herein involved upon appeal. After
organization of the Power Company the petitioner purchased al
its stock, loaned it $3,000,000 on open account, and purchased at
guaranteed, endorsed and sold to the public at 90 all of its $3,250
principal amount of first mortgage bonds. In 1927, pursuant
certificate of the Pennsylvania Public Service Commission, all of
assets of the Power Company were transferred to the petition
books, the operating deficit was charged against petition
87 surplus, the stock was surrendered for cancellation, the
account of $3,000,000 was cancelled, and the bonds were
sumed by petitioner. Thereafter, during 1927, all of these bonds
retired by petitioner, and there remained unamortized $308,067.9
debt discount and expense incurred on their issuance.

First, that the unamortized discount and expense upon the re
ment of said bonds by your petitioner is a proper deduction in c
puting petitioner's income, because of the identity and relations
between your petitioner and its said affiliated subsidiary, Metrop
tan Power Company, as a matter of fact and consequence of law.

Second, that under the foregoing facts the Power Company
a mere department or instrumentality of the petitioner, and that

bonds were at all times in substance and reality the bonds of the petitioner, as they were in fact its obligations.

Third, that the Commissioner should have applied the provisions of Section 240 of the Revenue Act of 1926 by allocating the deductions for unamortized discount and expense to the petitioner in order accurately to distribute such deductions.

(b) In 1928, the petitioner called and retired certain bonds of Cumberland Valley Light & Power Co., York Haven Water & Power Co., Hanover Power Co., and Pennsylvania Edison Co., which had theretofore been assumed by petitioner by merger under the laws of Pennsylvania. The franchises and assets of these companies had been acquired by petitioner pursuant to the provisions of the Acts of the Pennsylvania General Assembly of April 29, 1874, and April 17, 1876. The Board held that such so-called mergers amounted
88 in effect to sales of assets, and therefore that the unamortized discount and expense applicable to said bonds was not deductible.

It is the contention of the petitioner:

First, that the unamortized discount and expense upon the retirement of said bonds by your petitioner is a proper deduction in computing petitioner's income, because of the identity and relationship between your petitioner and its said affiliated subsidiaries, Cumberland Valley Light and Power Company, Metropolitan Electric Company, York Haven Power Company, Hanover Power Company, and Pennsylvania Edison Company, as a matter of law.

Second, that a transfer of assets pursuant to the aforementioned Acts of Pennsylvania General Assembly is in fact and in law a statutory merger.

Third, that the petitioner became entitled as the result of the statutory merger to deduct the unamortized discount and expenses on the retired bonds.

Fourth, that even if such transfer is not a statutory merger, the acquisition and assumption are such as to make the acquiring corporation a continuation of the transferring corporation with respect to the latter's corporate franchise and liabilities, and therefore that the deduction is proper.

IV. Assignment of Errors

The petitioner respectfully submits that in the decision and order of the Board redetermining the said deficiencies manifest error occurred and intervened to the prejudice of the petitioner, and, as the basis for its petition for review, assigns as errors:

(1) The failure of the Board to allow petitioner a deduction for its gross income for the calendar year 1927 for the unamortized
89 discount and expense applicable to the bonds of Metropolitan Power Company retired by petitioner during said year;

(2) The failure of the Board to allow petitioner a deduction from its gross income for the calendar year 1928 for the unamortized dis-

count and expense applicable to the bonds of Cumberland Valley Light & Power Company, York Haven Water & Power Company, Hanover Power Company, Metropolitan Electric Company and Pennsylvania Edison Company retired by petitioner during said year; and

(3) The finding by the Board that there was any deficiency for either of the calendar years 1927 or 1928; and

(4) The failure of the Board to find that petitioner had overpaid its income taxes for the periods stated.

Wherefore, your petitioner prays that this Honorable Court may review the decision of the United States Board of Tax Appeals and reverse and set aside the same, or modify the same, or grant such other relief as justice may require, and that the clerk of the said United States Board of Tax Appeals be directed to transfer and deliver to the clerk of this court certified copies of all and every of the documents necessary and material to the presentation and consideration of this petition for review; all as required by the rules of this Court and the statutes made and provided.

And your petitioner will every pray.

METROPOLITAN EDISON COMPANY.
By FRANCIS J. SWEENEY.
WALTER BIDDLE SAUL,
C. M. TRAMMELL,
BRADFORD S. MAGILL.

90 [*Duly sworn to by Charles M. Trammell; jurat omitted in printing.*]

91 Before United States Board of Tax Appeals

Notice of filing petition for review

Filed September 29, 1937

To the General Counsel for the Treasury Department:

You are hereby notified that on the twenty-ninth day of September 1937 the petitioner, the Metropolitan Edison Company, did file with the clerk of the United States Board of Tax Appeals at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Third Circuit of the decision of the Board of Tax Appeals heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error, as filed, is attached hereto and served upon you.

Dated this twenty-ninth day of September A. D. 1937.

FRANCIS J. SWEENEY.
WALTER BIDDLE SAUL.
C. M. TRAMMELL.
BRADFORD S. MAGILL.
Attorneys for Metropolitan Edison Company.

Copy of the foregoing notice, together with copy of the petition for review, is received and service thereof is hereby accepted this twenty-ninth day of September A. D. 1937.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

92 Before United States Board of Tax Appeals

Praecipe for record

Filed September 29, 1937

To the Clerk of the United States Board of Tax Appeals:

You will please prepare within sixty (60) days from the date of the filing of the petition for review in the above-entitled case, transmit, and deliver to the clerk of the United States Circuit Court of Appeals for the Third Circuit copies, duly certified as correct, of the following documents:

1. Prepare docket entries of proceedings before the Board of Tax Appeals.
2. Pleadings before the Board, including copy of notice of deficiency attached to petition.
3. Findings of fact, opinion, and decision of the Board.
4. Petition for review and assignments of error, together with proof of service of notice of filing petition for review and assignments of error.
5. This praecipe.

C. M. TRAMMELL,
Attorney for Petitioner.

Service of a copy of the within praecipe is hereby admitted this twenty-ninth day of September 1937.

J. P. WENCHEL,
Attorney for Respondent on Review.

93 [Clerk's certificate to foregoing transcript omitted in printing.]

94 In United States Circuit Court of Appeals for the Third Circuit

[Title omitted.]

Minute entry of argument

And afterwards, to wit, the 8th day of April 1938, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable Joseph Buffington, Honorable J. Warren Davis, and Honorable John Biggs, Jr., Circuit Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof.

And afterwards, to wit, on the 23d day of August 1938, come th parties aforesaid by their counsel aforesaid, and the Court, no being fully advised in the premises, renders the following decision

95 In United States Circuit Court of Appeals for the Third Circu

No. 6612. March Term, 1938

METROPOLITAN EDISON COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review From the United States Board of Tax Appeal

Opinion

Filed August 23, 1938

Before BUFFINGTON, DAVIS, and BIGGS, Circuit Judges.

DAVIS, Circuit Judge. This is an appeal from an order of rede termination, entered by the Board of Tax Appeals, holding that th petitioner is liable for deficiencies of $21,620.55 and $78,620.55 in it income tax returns for 1927 and 1928, respectively,

In determining these deficiencies, the Board upheld the contention of the commissioner that certain deductions claimed by the petitioner for the years in question, were not allowable. There were other issues involved before the Board which were determined in favor of the petitioner (35 B. T. A. 1110), but as the commissioner did not appeal, we are not concerned with them here.

96 In 1927 and 1928 after having absorbed certain of its subsidiaries, the petitioner redeemed for cash bonds previously issued by them and in its income tax returns for those years deducted the unamortized discount and expenses connected with the issuance of these bonds. The question is whether or not the petitioner had the right to make these deductions.

If the transactions by which the petitioner absorbed these subsidiaries constituted a true merger under the law of Pennsylvania, then the petitioner was entitled to the deductions claimed, but if they were sales and not mergers, then the Board correctly disallowed them.

The facts upon which the petitioner bases its claims for deductions are similar for both years, but we think that the opinion will be clearer if we take up those for 1928 first.

I. Deductions for 1928

In or prior to 1928 the petitioner absorbed four of its subsidiary corporations, the Cumberland Valley Light & Power Co., the York Haven Water & Power Co., the Hanover Power Co., and the Pennsyl-

vania Edison Co. These companies transferred all of their franchises and assets to the petitioner, which thereupon assumed all of their debts and returned to them for cancellation all of their capital stock. This was done in accordance with the provisions of the "short form merger statute," Purdons Pennsylvania Statutes, Title 15, Section 595, under whose provisions the subsidiaries ceased to exist. The petitioner then, in 1928, redeemed for cash, the bonds which these companies had previously issued totalling $11,142,900 and also paid premiums on them amounting to $645,251.34. When these bonds were redeemed there remained unamortized discount and issu-
97 ing expenses amounting to $769,864.54. In its income tax return for that year, 1928, the petitioner claimed deductions for the premiums paid and the unamortized discount and expenses. The commissioner disallowed both deductions. On appeal to the Board, the deduction for premiums was allowed, but the deduction for unamortized discount and expenses was not allowed.

It is clear that the deduction would have been allowed if the petitioner, itself, had issued the bonds, Article 545 of Regulations 69; Article 68 of Regulations 74; Helvering v. Union Pacific Co., 293 U. S. 282; point I of the Board's opinion in this case, 35 B. T. A. 1117, or if it had advanced the money to the subsidiaries to redeem the bonds, and had thereafter filed a consolidated income tax return with them, Point II of the Board's opinion in this case, 35 B. T. A. 1117, 1118.

The "short form merger statute," which the petitioner followed in absorbing these subsidiaries, provides, in part, that any corporation, with the consent of its stock holders, is entitled to "sell, assign, dispose of, and convey to any corporation created under or accepting the provisions of the act, its franchises, and all its property, real, personal, and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing * * *."

In disallowing the deduction, the Board placed great stress on the words "sell" and "purchasing" contained in the statute, and also upon the use of similar words in the agreements attending the transactions, but these particular words are not decisive of the issue, for "whether a particular transaction is in reality a sale, conversion, consolidation, or merger, to a great extent depends upon the circumstances surrounding each particular case; and in determining
98 the question all elements of the transaction must be considered. There is no magic in the words applied to the transaction. Calling it a consolidation does not make it so, and giving it another name does not prevent it from being a consolidation" 14 (a) C. J. 1056; 15 Fletcher Cyclopedia Corporations, Sec. 7043.

The transactions by which the companies mentioned above were absorbed contained the following elements: (1) the subsidiary corporations transferred all of their franchises and assets to the petitioner in consideration for the assumption of their debts and return and

cancellation of all their capital stock; (2) the subsidiaries, by operation of law, thereupon ceased to exist; (3) the petitioner, an existing corporation before the alleged merger, continued to exist thereafter; and (4) the petitioner became liable for the debts of the absorbed subsidiaries both under the contract and by operation of law. 14(a) C. J. 1056 and 1072; 15 Fletcher Cyclopedia Corporations, Sec. 7121; 15 A. L. R. 1112; 30 A. L. R. 558; 39 A. L. R. 143; Montgomery Web Co. v. Dienelt, 133 Pa. 585; 19 Atl. 428; Maxler v. Freeport Bank, 275 Pa. 510; 119 Atl. 592; In re Buist's Estate, 297 Pa. 537; 147 Atl. 606; Kulka v. Nemirovsky, 321 Pa. 234; 182 Atl. 692; Commonwealth v. Merchants National Bank of Allentown, 323 Pa. 145; 185 Atl. 823; In re Harr, 323 Pa. 380; 186 Atl. 120.

These elements comprise all of the essential characteristics of a true merger, which is defined as the union "of two or more corporations by the transfer of property of all to one of them, which continues in existence, the others being swallowed up or merged therein. In regard to the survivorship of one of the constituent corporations, it differs from a 'consolidation' wherein all of the consolidating companies surrender their separate existence and become parts of a new corporation." Black's Law Dictionary, 2nd Ed.; Words & Phrases, 1904 Ed.; 14(a) C. J. 1054 et seq.; 15 Fletcher Cyclopedia Corporations, section 7041; Cortland Specialty Co. v. Commissioner, 60 Fed. (2d) 937 (C. C. A. 2).

In the recent case of General Gas and Electric Corp. v. Commissioner, Fed. (2d) (C. C. A. 2), decided July 18, 1938, the court was of the opinion that, since the "short form merger statute" contained no specific provision that the absorbing corporation became liable for the debts of the absorbed company, it, apart from contract, became "liable only on principles of fraudulent conveyance and to the extent of the assets received." It is true that in Merwine v. Mt. Pocono Light & Imp. Co., 304 Pa. 517; 156 Atl. 150, the only case cited on this point, the Supreme Court of Pennsylvania indicated that the absorbing corporation might possibly be held liable for the debts of the merged corporation on that principle. The Courts of Pennsylvania, however, have never held that the procedure under this Act did not result in a merger, but have often referred to it as a merger. Pennsylvania Utilities Co. v. Public Service Com., 89 Pa. Super. 612; Hey v. Springfield Water Co., 207 Pa. 38; 56 Atl. 265, 268; York Haven Water & Power Co. v. Public Service Com., 287 Pa. 241; 134 Atl. 419, 421; Commonwealth v. Huntington Gas Co., 11 Dist. 546; 26 Pa. C. C. 657. This carries the implication that independently of the law of fraudulent conveyances the absorbing corporation is liable for the debts of the absorbed corporation. Commonwealth v. Merchants National Bank of Allentown, supra.

The "short form merger statute" of 1876, as amended was the only statute until the passage of the Corporation Laws of 1933, which provided a method for a true merger. The so-called "long form merger statute" (Purdon's Pennsylvania Statutes, Title 15, sec-

100 tions 421, 422 and 423) provided only for consolidation. It expressly required the formation of a new corporation to take over the assets of the merged corporations. Pennsylvania Co. etc. v. Commissioner 75 Fed. (2d) 719, 721 (C. C. A. 3).

In the case of General Gas & Electric, supra, it was pointed out that, for the purposes of actions pending against it, an absorbed corporation continues to exist. Merwine v. Mt. Pocono Light & Improvement Co. supra. But we have not found any cases which hold that the absorbed corporation under the "long form merger statute" does not also continue to exist for that purpose, and the language used in section 423 indicates that it does so continue to exist. Both the short and the long form statute are equally explicit in providing that the absorbed corporation ceases to exist. It would, therefore, appear that the effect of a merger under both statutes is the same in this respect.

The fact that the word "sale" is used in the "short form merger statute" is not of itself conclusive, for a sale may be one of the steps of a merger. 8 Thompson on Corporations (3rd Ed.), section 6013; Chicago S. F. & Calif. R. Co. v. Ashling, 160 Ill. 373, 380, 381; 43 N. E. 373, 375; Continental Trust Co. v. Toledo St. L. & K. C. R. Co., 82 Fed. 642 (C. C. A. 7). Clearly the transactions here involved do not constitute a true sale, for that implies a transfer of property for consideration in money. Blacks Law Dictionary (2d ed.); Cortland Specialty Co. v. Commissioner, supra. If the concepts of barter and exchange are included in the word "sale," it would be difficult to find any merger which did not contain some; if not all, of the elements of a sale. In every case of merger which we have been able to discover, the absorbing corporation, in return for the assets of a merged corporation, gave some consideration either to the merged company, its stockholders or its nominees. If this be considered a "sale" then practically every merger is a sale.

101 We are convinced that the transactions, by means of which the petitioner absorbed the subsidiaries here involved, partook of all of the essential elements of a merger (Chicago, S. F. & C. Ry. Co. v. Ashling, supra), and that the petitioner is entitled to the deduction claimed for 1928. American Gas & Elec. Co. v. Commissioner, 85 Fed. (2d) 527 (C. C. A. 2); New York Cent. R. Co. v. Commissioner, 79 Fed. (2d) 247 (C. C. A. 2); cert. den. 296 U. S. 653; Western Maryland Ry. Co. v. Commissioner, 33 Fed. (2d) 695 (C. C. A. 4); American Gas & Elec. Co. v. U. S., 17 Fed. Supp. 151 (Ct. Cls.).

II. Deduction for 1927

In 1923, the petitioner formed the Metropolitan Power Company, hereinafter called the Power Company, for the purpose of building and operating a large electric generating station on the Susquehanna River in Dauphin County, Pennsylvania. The petitioner purchased all of its capital stock, loaned it $3,000,000, guaranteed its bond issue of $3,250,000 and purchased all of its power. As the Board found, the

petitioner with the exception of the bondholders, was its sole creditor. The reason for creating the Power Company was to secure the bond issue by a first mortgage on the plant. It had no public franchises.

In 1927, after having obtained the permission of the Public Service Commission of Pennsylvania, the Power Company transferred all of its assets to the petitioner and in return the petitioner surrendered all of the capital stock of the Power Company for cancellation, cancelled the indebtedness of $3,000,000 and assumed all of its liabilities.

This procedure, technically, was not within the provisions of any merger statute, but there is no question as to its legality. The
102 reason given for not following the provisions of the "short form merger statute" was that the Power Company possessed no public franchises. 35 B. T. A. 1113 (finding of fact No. 3). However, this procedure in form and effect is practically and substantially that which the "short form statute" prescribes.

After having absorbed the Power Company, the petitioner, in 1927, redeemed for cash the bonds previously issued by the Power Company totaling $3,250,000. It paid premiums on these bonds amounting to $243,645 and there existed unamortized discount and expenses totaling $308,097.90. In its income tax return for 1927, the petitioner claimed deductions for both the amount of the premiums paid and the unamortized discount and expenses. The Board allowed the former but disallowed the latter deduction.

The same question as was involved in the deduction for 1928 is also here involved, and that is whether or not the transaction of absorption was a merger.

The analysis of this transaction shows: (1) that the Power Company transferred all of its assets to the petitioner; (2) that the petitioner was an existing corporation and continued to exist; (3) that the Power Company, though it did not automatically cease to exist upon the completion of the transaction, did discontinue all operations and was left without stockholders or property of any sort, and (4) that the petitioner, both by contract and operation of law, became liable for the debts of the Power Company. 14 C. J. 970; 15 Fletcher Cyclopedia Corporations, section 7127; In re Harr, supra; In re Buist's Estate, supra; Commonwealth v. Merchants Nat. Bank of Allentown, supra.

The only difference between the above procedure and that followed by the petitioner under the "short form merger statute" with reference
103 to the 1928 deduction was that the Power Company continued to exist nominally, while the Cumberland, York-Haven, Hanover and Pennsylvania Edison Companies automatically under the statute ceased to exist except as noted above. This was a mere technical, and not a practical or substantial difference, and should not determine the rights of the parties. Moreover, the transfer by the Power Company of all of its assets and cancellation of all of its stock effected its de facto dissolution (14 (a) C. J. 1117; Lauman v. Lebanon Valley R Co., 30 Pa. 42; Reynolds v. Cridge, 1 Dist. 693; 11 Pa. C. C. 306; Commonwealth v. Altoona & P. C. R. Co., 32 Pa.

C. C. 449; Skirvin Operating Co. v. Southwestern Electric Co., 174 Pac. 1069, 15 A. L. R. 1104, 1110), and its formal dissolution in January 1928 was only a declaration of that fact. 14 (a) C. J. 1118.

It follows that the petitioner was also entitled to the deduction for 1927 and the order of redetermination of the Board must be set aside and the case remanded to it with directions to proceed to redetermine the tax of the petitioner in accordance with this opinion.

A true Copy:
Teste:

Clerk of the United States Circuit Court of Appeals for the Third Circuit.

104 In United States Circuit Court of Appeals for the Third Circuit

No. 6612. March Term, 1938

METROPOLITAN EDISON COMPANY, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment

Filed August 23, 1938

Appeal from the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order or decree of the said Board of Tax Appeals in this cause be, and the same is hereby reversed, with directions to the said Board of Tax Appeals to redetermine the tax of the petitioner in accordance with the opinion of this Court.

Philadelphia, August 23, 1938.

J. WARREN DAVIS,
Circuit Judge.

[File endorsement omitted.]

105 [Clerk's certificate to foregoing transcript omitted in printing.]

106 Supreme Court of the United States

Order allowing certiorari

Filed January 3, 1939

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE 1939

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

No. 487

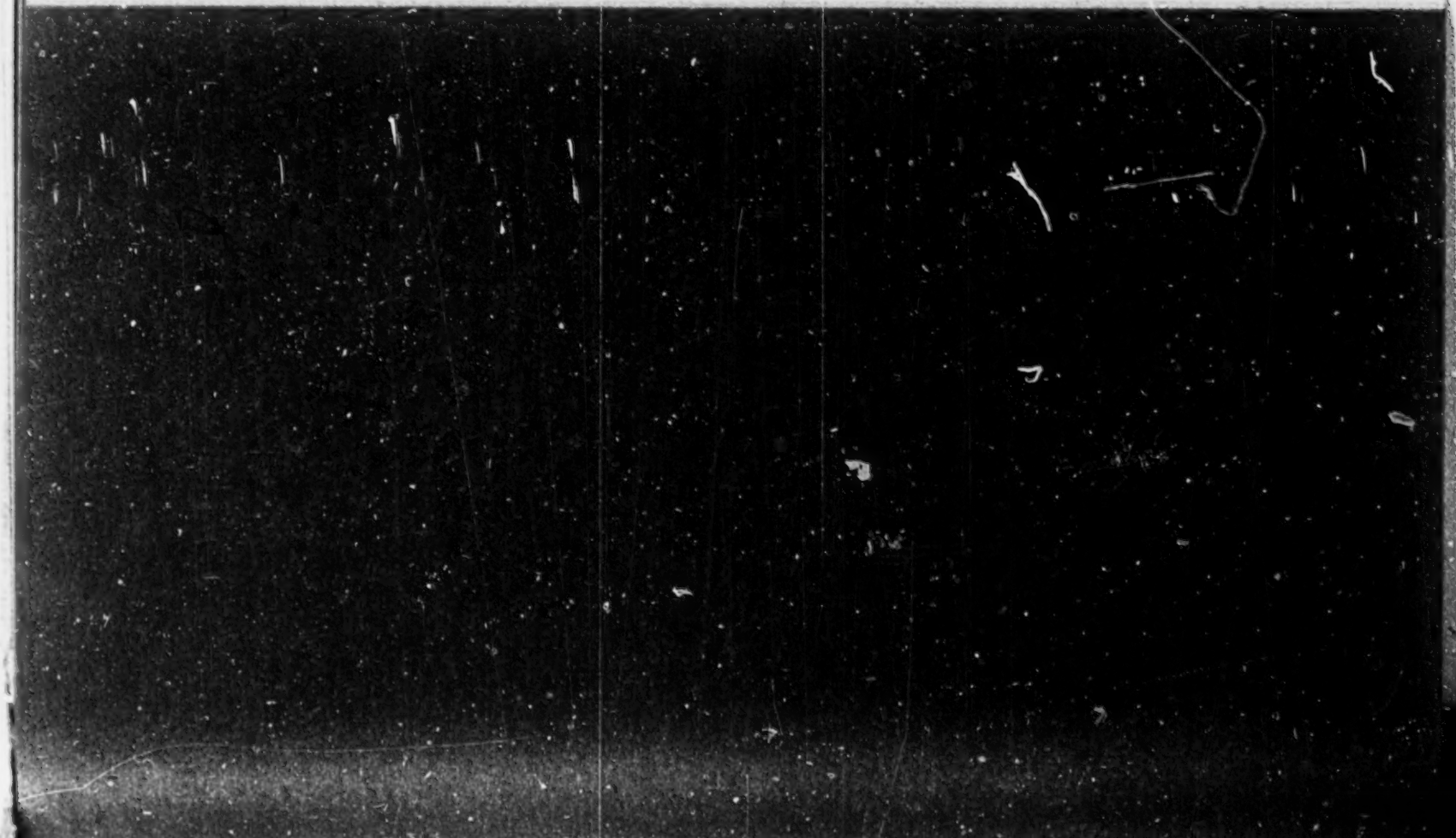
GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

PENNSYLVANIA WATER & POWER COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI, FILED NOVEMBER 23, 1938
CERTIORARI GRANTED JANUARY 3, 1939



SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

No. 487

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

PENNSYLVANIA WATER & POWER COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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121403—39——1

1 Before United States Board of Tax Appeals

Docket No. 56720

PENNSYLVANIA WATER & POWER COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: Edward J. Stegman, (withdrawn), Edwin M. Sturtevant, Clyde T. Warren. For Commissioner: F. Schlosser, Esq., Wm. E. Davis, Esq.

Docket entries

Apr. 18, 1931—Petition received and filed. Taxpayer notified. (Fee paid)

Apr. 18, 1931—Copy of petition served on General Counsel.

May 27, 1931—Motion for order to show cause (imperfect petition), filed by General Counsel.

June 3, 1931—Hearing set June 24, 1931 on motion.

June 24, 1931—Hearing had before Mr. Smith on motion. Denied. Usual time to answer.

June 24, 1931—Order denying motion and that respondent be given usual time to answer or move, entered.

2 Oct. 17, 1931—Answer filed by General Counsel.

Oct. 20, 1931—Copy of answer served on taxpayer. General Calendar.

Dec. 3, 1931—Notice of appearance of Edwin M. Sturtevant as counsel filed.

Jan. 11, 1933—Hearing set Feb. 9, 1933.

Feb. 1, 1933—Motion for continuance filed by taxpayer. 2/4/33. Granted to 4/20/33.

Feb. 1, 1933—Notice to serve all papers on Mr. Edwin M. Sturtevant filed by Treasurer of taxpayer.

Feb. 2, 1933—Notice of withdrawal of Edward J. Stegman as counsel filed.

Apr. 5, 1933—Motion to place on the Reserve Calendar filed by taxpayer. 4/7/33. Granted to Fall 1933.

Oct. 2, 1936—Hearing set Nov. 30, 1936.

Nov. 30, 1936—Hearing had before Mr. A. J. Mellott, Div. 11. Stipulation of facts and exhibits 1, 2, 3, & 4 filed. Petitioner's brief due 1/14/37. Respondent's 2/13/37. Pet.'s reply Mar. 1, 1937.

Dec. 8, 1936—Transcript of hearing of Nov. 30, 1936, filed.

Dec. 10, 1936—Brief filed by taxpayer. 12/10/36 copy served.

Feb. 6, 1937—Brief filed by General Counsel.

Aug. 24, 1937—Opinion rendered, Arthur J. Mellott, Div. 11. Judgment will be entered under Rule 50

3 Sept. 24, 1937—Notice of settlement filed by General Counsel.

Sept. 27, 1937—Hearing set Oct. 20, 1937 on settlement.

Oct. 4, 1937—Motion to substitute the attached recomputation in place of that filed Sept. 24, 1937, filed by General Counsel.

Oct. 9, 1937—Consent to substituted computation filed by taxpayer.

Oct. 16, 1937—Decision entered, Div. 15, Eugene Black.

Nov. 3, 1937—Notice of appearance of Clyde T. Warren as counsel filed.
Dec. 22, 1937—Petition for review by United States Circuit Court of Appeals, Third Circuit, with assignments of error filed by taxpayer.
Dec. 22, 1937—Proof of service filed by taxpayer.
Dec. 29, 1937—Agreed statement of evidence lodged.
Dec. 29, 1937—Agreed præcipe filed.
Dec. 20, 1937—Agreed statement of evidence approved and ordered filed.

4 Before United States Board of Tax Appeals

Docket No. 56720

PENNSYLVANIA WATER AND POWER COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition

Filed April 18, 1931

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice IT:AR:C-8 DBH-60D, dated February 18, 1931, and as a basis of its proceeding alleges as follows:

1. The petitioner, Pennsylvania Water and Power Company, is a corporation, organized under the laws of Pennsylvania, having its principal office at Holtwood, Pennsylvania.

2. The notice of deficiency, a copy of which is attached hereto and marked "Exhibit A," was mailed to the petitioner on February 18, 1931.

3. The taxes in controversy are income taxes for the calendar year 1928 in the amount of $87,351.57.

4. The determination of the tax set forth in the said notice of deficiency is based upon the following errors:

5 The disallowance of unamortized bond discount and expense together with premiums paid to retire bonds which were called in on March 1, 1928, as follows:

A. The unamortized portion (as of March 1, 1928) of the discount and expense on the $3,000,000.00 par value of the petitioner's 5½ Per Cent. Bonds, originally due October 1, 1953, on their retirement on March 1, 1928	$203,573.88
B. The premium paid upon the retirement of the petitioner's 5½ Per Cent. Bonds on March 1, 1928	195,000.00
C. The amortization of discount and expense applicable to the Holtwood Power Company Bonds for the months of January and February, 1928	904.42
D. The unamortized portion (as of March 1, 1928) of the discount and expense on the $2,750,000.00 par value Holtwood Power Company 6 Per Cent. Bonds, originally due September 1, 1954, upon the retirement of said bonds on March 1, 1928	144,255.10
E. Premium paid upon the retirement of the Holtwood Power Company Bonds, March 1, 1928	192,500.00
Total	$736,233.40

	F. Less deduction of additional amortization of bond discount, premium and expenses allowed by the Commissioner as a result of prorating over the life of the 4½ Per Cent. Bonds (issued by Pennsylvania Water and Power Company as of March 1, 1928, the proceeds of which were used in part to retire petitioner's 5½ Per Cent. Bonds) the bond discount, premium and expenses of the 5½ Per Cent. Bonds disallowed as a deduction for the year 1928 in Sections A and B	8,303.63
	Total disallowed	$727,929.77

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

PETITIONER'S 5½ PER CENT. BONDS

(1) The petitioner was incorporated under the laws of the State of Pennsylvania on January 13, 1910. The petitioner was from 1910 to 1928, and is, engaged in the business of producing, transmitting and selling electric power, in the States of Maryland and Pennsylvania.

(2) The petitioner sold to the public a total of $3,000,000 par value of its 5½ per cent. bonds, originally due October 1, 1953 as follows:— In November 1923, $2,000,000; in July 1924, $1,000,000, and received, therefor, a total of $2,767,500.

(3) The difference between the par value of these bonds ($3,000,000) and the amount received for them ($2,787,500), amounting to $212,500 was entered on the petitioner's books as "Unamortized Bond Discount & Expense." Expenses in the amount of $23,868.20 were incurred by the Petitioner in connection with the floating of these bonds, which amount was added to the "Unamortized Bond Discount and Expense" account. During each of the years 1923 to 1927, inclusive, and for the period January 1 to February 29, 1928, an amortization of the bond discount and expense referred to above at the rate of 3⅓ per cent. per year, was used as a deduction in petitioner's consolidated income tax returns for the years mentioned, and was approved by the Commissioner or his agent. The total of the amounts so used up to and including February 29, 1928 was $32,794.32, leaving a balance not so used of $203,573.88.

(4) On March 1, 1928, the petitioner issued its 4½ per cent. bonds, due March 1, 1968, in the amount of $6,000,000 par value.

(5) On March 1, 1928, the petitioner called in for payment all of its outstanding 5½ per cent. bonds, of a total par value of $3,000,000, paying therefor par plus a premium of 6½ per cent., or a total of $3,195,000.

(6) Upon the retirement of these bonds the unamortized balance of the discount and expenses applicable thereto, in the amount of $203,573.88, became valueless to the petitioner, and was deductible as an ordinary and necessary business expense in the petitioner's 1928 income tax return.

(7) The premium paid ($195,000) to retire the petitioner's 5½ per cent. bonds was an ordinary and necessary business expense of the petitioner in 1928.

(8) The Commissioner has disallowed as deductions for 1928 the unamortized balance of the bond discount and expense applicable to the petitioner's 5½ per cent. bonds as of March 1, 1928, in the amount of $203,573.88, and the premium of $195,000 paid to retire these bonds, and holds that these items are additional cost of floating the new issue of 4½ per cent. bonds.

8 (9) The Commissioner has allowed as an additional deduction 10/12 of 1/40 of the amounts disallowed in Paragraph 8, as amortization of additional discount and expense on the new issue of 4½ per cent. bonds for the period March 1 to December 31, 1928.

HOLTWOOD POWER COMPANY BONDS

(10) Prior to 1924, all of petitioner's power was produced by water-power at a hydro-electric plant located on the Susquehanna River at Holtwood, Pennsylvania. In 1924 the petitioner found it necessary to augment its hydro-electric power plant by a steam-driven power plant, and it organized the Holtwood Power Company to carry on this activity. The Holtwood Power Company was accordingly incorporated on August 9, 1924, under the laws of the State of Pennsylvania, with an authorized capital of $1,500,000.

(11) The entire capital stock of the Holtwood Power Company was subscribed for by, and issued to, the petitioner between August, 1924 and December, 1924. The petitioner paid said Holtwood Power Company $1,500,000 in cash and property, between August, 1924 and December, 1924, in payment of this stock.

(12) During the entire life of the Holtwood Power Company, all of its capital stock was owned and held by the petitioner. The petitioner had at all times complete and absolute control of the Holtwood Power Company. The operations of the Holtwood Power Company were included in the petitioner's consolidated income tax returns during its entire life. The petitioner entered into an agreement, attached hereto as Exhibit "B", with the Holtwood Power Company, dated August 26, 1924, reading in part as follows:

9 "2. The Steam Company agrees that (subject to its obligations as a public utility) it will deliver, on the order of the Power Company, electric power up to the full capacity of the Steam Company's plant.

"3. The Power Company shall pay to Steam Company as compensation hereunder a sum sufficient to provide Steam Company the following:

"(a) All costs of management, operation, and maintenance.

"(b) An allowance for setting up depreciation, obsolescence, and renewal and replacement reserves or any of them in accordance with the standards accepted by the Pennsylvania Public Service Commission and agreed to by the parties hereto.

"(c) A sum to provide for amortization of debt, discount, and security issue expense.

"(d) A sum sufficient to provide a net return of eight per cent. annually upon the par value of its securities including its paid up stock.

"(e) Payments to be made by Power Company under Section a, paragraph 3, above, shall include any and all sums necessary for the purpose of defraying the expenses of maintaining the corporate organization of the Steam Company; the expenses attending the issuing, registration, and transfer of the capital stock and bonds of the Steam Company, now or hereafter issued and outstanding, and all interest on its bonded or other indebtedness at any time outstanding or existing, as and when said several interest payments may become
10 due and payable; sinking fund requirements of its first mortgage or other bonds, in accordance with the provisions of the mortgage or deed of trust securing such bonds; all Federal, State, Municipal and other taxes, charges, licenses, and assessments, now or hereafter lawfully imposed upon the Steam Company or for which it may in any manner be liable or chargeable on account of its corporate existence, its franchises, property, real or personal, business, earnings, bonds, capital stock, dividends, or profits and any sum which shall hereafter be levied or assessed on any shareholder of the Steam Company or upon its share by way of direct tax upon said share or the income thereof, which the Steam Company shall or may be required to pay on behalf of or retain from any such shareholder or bondholder; all fire, storm, lightning, accident, compensation, public liability, or other insurance premiums which the Steam Company may be required or deem advisable to carry; all legal expenses and other expenses whatsoever from time to time as the same may arise not otherwise specifically covered by the terms of this agreement. The intent and purpose of these provisions being that the Power Company shall at all times pay or provide for the payment of every obligation and expense of the Steam Company in order to enable the latter to realize a net return of eight per cent. annually upon the par value of all of its securities at any time outstanding."

11 The only purpose of the organization and existence of the Holtwood Power Company was to enable the petitioner to engage in the steam-power business. The Holtwood Power Company was in effect merely a part of the petitioner's plant.

(13) On or about September 1, 1924, an issue of 30-year 6 per cent. bonds of a total par value of $2,750,000 was sold to the public by the Holtwood Power Company for a total of $2,612,500. These bonds were in effect the petitioner's obligations at the moment of their issue, and at all times subsequent thereto.

(14) The difference between the par value ($2,750,000) of said bonds and the amount received for them ($2,612,500), amounting to $137,500 was entered on the books of the Holtwood Power Company as "Unamortized Bond Discount and Expense." Expenses were incurred in connection with the floating of these bonds, in the

amount of $25,249.87, which amount was added to the "Unamortized Bond Discount and Expense" account. During each of the years 1924, 1925, 1926, and 1927 an amortization of the bond discount and expense at the rate of 3⅓ per cent. of the total per year was used as a deduction in petitioner's consolidated income tax returns for the years mentioned and was approved by the Commissioner or his agent. The total of the amounts so used to and including the taxable year 1927 was $17,590.35, leaving a balance not so used of $145,159.52 at December 31, 1927.

(15) In December 1927 the Holtwood Power Company was merged with the petitioner. The petitioner surrendered its stock in the Holtwood Power Company to it for cancellation as
12 of December 1, 1927, and in exchange therefor received all the assets of the Holtwood Power Company and assumed all of its liabilities.

(16) Among the assets received by petitioner from the Holtwood Power Company were "Unamortized Bond Discount and Expense" in the amount of $145,611.73, and among the liabilities assumed were "Mortgage Bonds Payable" in the amount of $2,750,000. In January 1928 the Holtwood Power Company ceased to exist.

(17) Upon the merger referred to above the assets and liabilities of the Holtwood Power Company became in law and fact what they had already been in effect—the assets and liabilities of the petitioner. The merger was a change in form only; it was not a change in substance. The degree of control and ownership by the petitioner of the Holtwood Power Company assets and liabilities was not changed by the merger. The petitioner became the legal successor to the Holtwood Power Company and, as such, succeeded to all the rights and obligations of the Holtwood Power Company, including the right to deduct in its income tax returns any items which the Holtwood Company had the right to deduct, and the obligation to redeem the bonds at par at maturity, with the option to retire said bonds at premium before the date of maturity.

(18) On March 1, 1928, the petitioner, pursuant to its option, called in for retirement all of the outstanding 6 per cent. bonds of the Holtwood Power Company, of a total par value of $2,750,000, paying therefor par plus a premium of 7 per cent., or a total of $2,942,500.

(19) The payment of this premium was, under the terms of the indenture, necessary in order to retire these bonds.

13 (20) These bonds of the Holtwood Power Company were, at the time of their retirement, the direct obligations of the petitioner.

(21) Upon the retirement of these bonds the unamortized balance of the discount and expenses applicable thereto, in the amount of $144,255.10, became valueless to the petitioner, and was deductible

as an ordinary and necessary business expense in petitioner's 1928 income tax return.

(22) The premium paid to retire the Holtwood Power Company bonds ($192,500) was an ordinary and necessary business expense of the petitioner in 1928 and was deducted in petitioner's income tax return for that year.

(23) The petitioner used as a deduction in its 1928 income tax return an amortization of bond discount and expense applicable to the bonds of the Holtwood Power Company for the period January 1, 1928, to February 29, 1928. This deduction amounting to $904.42, was an ordinary and necessary business expense of the petitioner in 1928.

(24) The Commissioner has disallowed as deductions for 1928:

(a) The unamortized balance of the bond discount and expense applicable to the bonds of the Holtwood Power Company as of March 1, 1928, in the amount of $144,255.10;

(b) The premium of $192,500 paid to retire the Holtwood Power Company bonds;

(c) The amortization of discount and expense, applicable to the Holtwood Power Company bonds, for the period January 1 to February 29, 1928, in the amount of $904.42.

6. Wherefore, the petitioner prays that this Board may hear the proceedings and determine that:

(1) The petitioner succeeded to all the rights and obligations of the Holtwood Power Company, and was entitled to treat its bonds payable, and unamortized discount and expenses as its own.

(2) The unamortized balance of Holtwood Power Company's bond discount and expense as of March 1, 1928, the amortization thereof for January and February, 1928, and the premium paid to retire the Holtwood bonds, were ordinary and necessary business expenses of the petitioner in 1928.

(3) The unamortized balance of discount and expense, as of March 1, 1928, applicable to petitioner's 5½ per cent bonds, and the premium paid to retire these bonds were ordinary and necessary business expenses in 1928.

(4) That there has been an over-assessment of $727,929.77 in income, or $87,351.57 in tax, for the year 1928.

PENNSYLVANIA WATER AND POWER COMPANY,
[SEAL] By JAS. L. RINTOUL, *Treasurer.*
EDWARD J. STEGEMAN,
Counsel for Petitioner,
1214 Continental Bldg., Baltimore, Maryland.
EDWIN M. STURTEVANT,
Counsel for Petitioner,
1707 Lexington Bldg., Baltimore, Maryland.

[*Duly sworn to by James L. Rintoul; jurat omitted in printing.*]

16 *Exhibit A to petition*

TREASURY DEPARTMENT,
Washington, February 18, 1931.

PENNSYLVANIA WATER AND POWER COMPANY,
Lexington Building, Baltimore, Maryland.

SIRS: You are advised that the determination of your tax liability for the year 1928 discloses a deficiency of $86,508.25, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

HOWEVER, IF YOU DO NOT DESIRE TO PETITION, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,
Commissioner.
By J. C. WILMER,
Deputy Commissioner.

Enclosures:
Statement.
Form 882.
Form 870.
Schedules 1 to 7, inclusive.

17 IT:AR:C-8.
DBH-60D.

STATEMENT

Companies included in the Consolidation:	Returns examined for the years
Parent Company:	
Pennsylvania Water and Power Company, Lexington Building, Baltimore, Maryland	1928
Subsidiary Companies:	
The Baltimore Electro Alloys Company, Lexington Building, Baltimore, Maryland	1928
Holtwood Coal Company, Lexington Building, Baltimore, Maryland	1928
McCall Ferry Company, Lexington Building, Baltimore, Maryland	1928
Susquehanna Falls Power Company, Lexington Building, Baltimore, Maryland	1928
Susquehanna Canal and Power Company, Lexington Building, Baltimore, Maryland	1928
Susquehanna Transmission Company of Maryland, Lexington Building, Baltimore, Maryland	1928
Susquehanna Transmission Company of Pennsylvania, Lexington Building, Baltimore, Maryland	1928
18 Susquehanna Storage, Lake and Power Company, Lexington Building, Baltimore, Maryland	1928
York Furnace Electric Company, Lexington Building, Baltimore, Maryland	1928

TAX LIABILITY

PENNSYLVANIA WATER AND POWER COMPANY

Year	Tax Liability	Tax Assessed	Deficiency
1928	$261,314.13	$174,805.88	$86,508.25

The adjustments resulting in the above deficiency are set forth in a revenue agent's report, a copy of which you have and schedules attached hereto.

In determining the above deficiency careful consideration has been given to the contentions raised in your protest and at a conference in this office on February 2, 1931, to the adjustment for bond discount and expenses. Your contentions must, however, be denied.

The entire tax liability has been allocated to the Pennsylvania Water and Power Company in accordance with allocation agreement on file in this office.

A carbon of this letter has been mailed to Mr. Edward J. Stegman, 1214 Continental Building, Baltimore, in accordance with a power of attorney, running to him which is on file in this office.

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SCHEDULE 1

PENNSYLVANIA WATER AND POWER COMPANY—YEAR ENDED DECEMBER 31, 192

NET INCOME

Net income as disclosed by return		$1,406,237.3
As corrected		2,127,139.4
Net adjustment		720,902.0
Unallowable deductions and additional income:		
(a) Bond discount and expenses—adjustment	$727,929.77	
(b) Donations	1,000.00	
Total		728,902.7
Non-taxable income and additional deduction:		
(c) Taxes—adjustment		8,027.7
Net adjustment as above		720,902.0

SCHEDULE 2

EXPLANATION OF ITEMS CHANGED

(a) As shown in Schedule L of your return bond discount in th amount of $789,949.81 has been deducted. An analysis of this deduc tion discloses that it consists of the following:

1. Amortization of bond discount and expenses—first mortgage 5% gold bonds	839,100.3
2. Loss on retirement of $96,000.00 par value—first mortgage 5% gold bonds	6,868.4
3. Unextinguished expense on above bonds retired	244.1
4. Amortization of bond discount and expenses—first refunding 5½% gold bonds	1,328.2
5. Unamortized bond discount and expense—first refunding 5½% gold bonds, retired March 1, 1928	203,573.8
6. Premium paid to retire above bonds	195,000.0
7. Amortization of bond discount and expenses—Holtwood Power Company first mortgage 6% gold bonds	904.4
8. Unamortized bond discount and expenses—Holtwood Power Company bonds retired March 1, 1928	144,255.1
9. Premium paid to retire Holtwood Power Company bonds	192,500.0
10. Amortization of bond discount and expense—first refunding 4½% gold bonds, issued March 1, 1928	6,177.2
Total	789,949.8

Items 1, 2, 3, and 4 are found to be correct and allowed.

Items 5 and 6, representing unamortized bond discount and expense of the First Refunding 5½% gold bonds and the premium paid to re tire said bonds are held to be additional cost of issuing Series B firs refunding 4½% gold bonds, and not a deductible expense in the yea in which the old bonds were retired. The new issue was floated for th specific purpose of retiring the 5½% bonds, and the benefit derive from the transactions are held to extend ratably over the life of th new bond issue.

Items 7, 8, and 9 are disallowed. This office holds that the unamor tized bond discount and expenses on bonds of a predecessor compan are not deductible by the successor corporation for the reason that th

20 latter company in assuming the liabilities of the former ha taken over the contractual obligation to redeem the bonds at

21 stipulated price, usually par or greater and no gain or loss i

derived or sustained by the successor corporation unless the obligation is liquidated at a lesser or greater amount than the stipulated price. A company selling a $100.00 bond at $95.00 redeemable at par has a prospective loss of $5.00 which is deductible ratably over the life of the bond, but a successor corporation assuming the bond at $100.00 and redeeming the same at $100.00 has sustained no loss. In your case the Holtwood Power Company bonds were callable at $107.00 and are presumed to have been taken over by your company at that figure, and as the bonds were redeemed at $107.00 no loss has been sustained by your company, either as a deductible expense in the year the bonds were redeemed or as additional cost of floating the new issue to retire them.

Item 10 is allowed in full and in addition thereto a further deduction resulting from the additional costs outlined above are allowed as follows:

Par value of first refunding 4½% gold bonds		$6,000,000.00
Selling price		5,730,000.00
Discount		$270,000.00
Direct expenses		26,507.37
Unamortized discount and expenses—first refunding 5½% gold bonds		203,573.88
Premium paid to retire above bonds		195,000.00
Total bond discount and expenses		$695,081.25
Life of bonds 40 years.		
Amortization of bond discount and expense applicable to 1928 (10 months)		$14,480.86
Deducted		6,177.23
Additional deduction		$8,303.63
Bond discount deducted on return		$789,949.81
2 Allowed:		
Amortization of discount and expense—first mortgage 5% gold bonds	$39,100.36	
Loss on retirement of $96,000 first mortgage 5% gold bonds (see below)	6,836.45	
Unextinguished expense on above bonds retired	244.15	
Amortization of bond discount and expenses—first refunding 5½% gold bonds retired March 1, 1928	1,320.22	
Amortization of bond discount and expenses—first refunding 4½% gold bonds issued March 1, 1928	14,480.86	$82,020.04
Disallowed		$727,929.77

LOSS ON BONDS RETIRED

Amount paid to acquire bonds		$90,522.20
Selling price	$88,224.00	
Discount taken up	4,429.75	92,653.75
Loss		$6,868.45

(b) Donations are not allowable deductions from gross income. Article 262, Regulations 74.

(c) Taxes applicable to the year 1928 have been allowed as a deduction.

Taxes paid and accrued applicable to 1928	$116,873.29
Taxes deducted on return	108,845.57
Additional deduction	8,027.72

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SCHEDULE 3

THE BALTIMORE ELECTRO ALLOYS COMPANY—YEAR ENDED DECEMBER 31, 1928

NET INCOME

Net income as disclosed by return	$33,852.9
As corrected	No chang

SCHEDULE 4

HOLTWOOD COAL COMPANY

NET INCOME

Net income as disclosed by return	$9,391.4
As corrected	No chang

SCHEDULE 5

MCCALL FERRY COMPANY

NET INCOME

Net income as disclosed by return	$7,233.8
As corrected	No chang

SCHEDULE 6

PENNSYLVANIA WATER AND POWER COMPANY

CONSOLIDATED NET INCOME

Net income as corrected:		
Pennsylvania Water and Power Company	$2,127,139.44	
The Baltimore Electro Alloys Company	33,852.97	
Holtwood Coal Company	9,391.48	
McCall Ferry Company	7,233.87	
Susquehanna Falls Power Company	----------	
Susquehanna Canal and Power Company	----------	
Susquehanna Transmission Company of Maryland	----------	
Susquehanna Transmission Company of Pennsylvania	----------	
Susquehanna Storage Lake and Power Company	----------	
York Furnace Electric Company	----------	
Consolidated net income		$2,177,617.76

SCHEDULE 7

COMPUTATION OF TAX

INCOME TAX

Net income for taxable year	$2,177,617.76
Income tax at 12%	261,314.13
Total previously assessed	174,805.88
Additional tax to be assessed	86,508.25

25 Before United States Board of Tax Appeals

Answer

Filed October 17, 1931

The Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits, denies, avers, and alleges as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar year 1928. Denies that the amount in controversy is as alleged in paragraph 3 of the petition.

4. Admits that in his notice of deficiency the Commissioner disallowed a net amount of $727,929.77 claimed on petitioner's income tax return as unamortized bond discount and expense and premiums paid upon the retirement of bonds. Denies that such action constituted error. Avers (in the alternative) that the Commissioner erred in allowing any amount as a deduction on account of unamortized discount and expense and premium in connection with any bonds issued prior to 1928.

5 (1) Admits that the petitioner was incorporated under the laws of the State of Pennsylvania. Admits that the petitioner was in 1928, and is, engaged in the business of producing, transmitting, and selling electric power in the States of Maryland and Pennsylvania. Alleges that petitioner was formed as the result of the merger mentioned in subparagraph (15) of paragraph 5 of the petition.

26 (2) Admits that prior to 1928 a total of $3,000,000 face value of 5½ per cent. bonds originally due October 1, 1953, had been issued by a corporation of the same name as petitioner and that the issuing corporation received for said bonds a total of $2,787,500.

(3) Admits that the difference between the par value of these bonds ($3,000,000) and the amount received for them ($2,787,500), amounting to $212,500, was entered on said corporation's books as unamortized bond discount and expense. Admits that expenses in the amount of $23,868.20 were incurred by said corporation in connection with the floating of these bonds, which amount was added to the unamortized bond discount and expense account. Admits that petitioner continued the use of the same books and that the unamortized bond discount and expense on these bonds as disclosed by said books at the close of business February 29, 1928, was $203,573.88.

(4) Admits that on March 1, 1928, the petitioner issued its 4½ per cent. bonds due March 1, 1968, in the amount of $6,000,000 par value. Avers that the purpose for which said bonds were issued was the refunding of the 5½ per cent. bonds above mentioned, and the 6 per cent. bonds of the Holtwood Power Company assumed by petitioner.

Avers that the proceeds of the sale of the new 4½ per cent. bond iss were used in their entirety to retire the bond issues mentioned in t preceding sentence.

(5) Admits that on March 1, 1928, the petitioner called in for pa ment all of the above-mentioned outstanding 5½ per cent. bonds of total par value of $3,000,000, paying therefor a total of $3,195,000.

(6) Denies each and every allegation of fact, if any, contained i subparagraph (6) of paragraph 5 of the petition.

27 (7). Denies each and every allegation of fact, if any, co tained in subparagraph (7) of paragraph 5 of the petition.

(8). Admits that the Commissioner has disallowed the unamortize balance of the bond discount and expense above mentioned amountin to $203,573.88, and the premium of $195,000 paid at the time of th retirement of said 5½ per cent. bonds. Admits that the responde held that said items constituted a part of the cost incurred in co nection with the issuance by petitioner on March 1, 1928, of $6,000,0 par value 4½ per cent. bonds due March 1, 1968.

(9). Admits that the Commissioner has allowed as an additiona deduction 10/12 of 1/40 of the unamortized discount amounting t $203,573.88 and premium of $195,000 as amortization of discount an expense on the new issue of 4½ per cent. bonds, as shown in detail o page 3 of the statement attached to the deficiency letter.

(10). Admits that the Holtwood Power Company was a corpora tion organized prior to 1927 under the laws of Pennsylvania. Denie each and every other allegation of fact contained in subparagraph (10) of paragraph 5 of the petition.

(11). Denies each and every allegation of fact contained in sub paragraph (11) of paragraph 5 of the petition.

(12). Denies each and every allegation of fact contained in sub paragraph (12) of paragraph 5 of the petition.

(13). Admits that in the year 1924 the Holtwood Power Company issued its 30 year 6 per cent. bonds of a total par value of

28 $2,750,000 for the sum of $2,612,500. Denies each and every other allegation of fact contained in subparagraph (13) of paragraph 5 of the petition.

(14). Admits that the difference between the par value ($2,750,000) of said bonds and the amount received for them ($2,612,500), amount ing to $137,500, was entered on the books of the Holtwood Power Company as unamortized bond discount and expense. Admits that expenses were incurred in connection with the floating of these bonds in the amount of $25,249.87, which amount was entered to the un amortized bond discount and expense account on the Holtwood Power Company books. Says that the remaining allegations contained in subparagraph (14) of paragraph 5 of the petition are immaterial, and therefore denies the same.

(15). Admits that about the end of the year 1927 or the beginning of 1928 the petitioner in connection with a certain merger acquired

all of the assets of the Holtwood Power Company, and in part consideration therefor assumed all of the liabilities of said company.

(16). Admits that among the liabilities of the Holtwood Power Company which were so assumed by the petitioner were the bonds payable in the face amount of $2,750,000. Denies all other allegations contained in subparagraph (16) of paragraph 5 of the petition.

(17). Denies each and every allegation of fact, if any, contained in subparagraph (17) of paragraph 5 of the petition.

(18). Admits that on March 1, 1928, the petitioner called in for retirement all of the outstanding 6 per cent. bonds issued by the Holtwood Power Company. Admits that the petitioner paid the sum of $2,942,500 in connection with the retirement of these bonds.

(19). Admits all the allegations of fact contained in subparagraph (19) of paragraph 5 of the petition.

(20). Admits all the allegations of fact contained in subparagraph (20) of paragraph 5 of the petition. Alleges that the obligation to pay the premium of 7 per cent. on said bonds was also, at the time of their retirement, the direct obligation of the petitioner, and that said obligations were assumed as part consideration for the acquisition of the assets of Holtwood Power Company.

(21). Denies each and every allegation of fact, if any, contained in subparagraph (21) of paragraph 5 of the petition.

(22). Admits that petitioner deducted said item of $192,500 in its income tax return for 1928, but denies each and every other allegation of fact contained in subparagraph (22) of paragraph 5 of the petition.

(23). Admits that the petitioner claimed a deduction on its income tax return for the year 1928 of $904.42 as amortization of bond discount and expense applicable to the bonds of the Holtwood Power Company for the period January 1, 1928, to February 29, 1928. Denies the remaining allegations contained in subparagraph (23) of paragraph 5 of the petition.

(24). Admits that the Commissioner disallowed as deductions for 1928 the amounts referred to in subparagraph (24) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in the taxpayer's petition not hereinbefore admitted, qualified or denied.

7. The respondent alleges in the alternative (in the event the Board does not sustain the action of the Commissioner in disallowing the amount of the unamortized bond discount and expense and the premium paid on the retirement of the bonds of the Holtwood Power Company) that said unamortized bond discount and expense and said premium are not deductible in their entirety in computing petitioner's net taxable income for the year 1928 for the reason that the amount of said items constituted a capital expenditure or a deferred expense in connection with the issuance of the new bonds, and should be amortized over the life of the bonds which petitioner issued on March 1, 1928.

8. Respondent further alleges in the alternative (in the event it
found and held that petitioner was not organized in 1910 but w
formed as the result of the merger of a prior corporation of the sa
name with the Holtwood Power Company) that petitioner acquire
the assets of said prior corporation of the same nam and as pa
consideration therefor assumed all the outstanding bonds of said pri
corporation, including the above-mentioned 5½ per cent. bonds du
October 1, 1953, of the total face value of $3,000,000; that petitioner di
not acquire as an asset any unamortized discount and expense on ac
count of any bonds of said prior corporation; that petitioner als
assumed as part consideration for the acquisition of said assets th
obligation to pay the 6½ per cent. premium as and when said bond
should be called for retirement; that all amounts in reference to an
bonds of said prior corporation constituted a part of the cost of th
assets so acquired, and no part thereof, whether principal, discount
expense, or premium, constituted an ordinary and necessary expens
of petitioner for the year 1928, or was otherwise deductible in com-
puting petitioner's net taxable income for 1928; that the Commissioner
erroneously allowed as deductions all amounts set forth on page 3
of the statement attached to the deficiency letter except the item
31 of $6,177.23 claimed and allowed as amortization of the dis-
count of $270,000 and expense of $26,507.37 in connection with
the issuance of petitioner's 4½ per cent. bonds on March 1, 1928; and
that the Commissioner thereby understand petitioner's taxable net
income, and the taxable net income of the affiliated group, for the
year 1928 by the amount of $75,902.81, which should be restored to
income in the redetermination of the deficiency.

Wherefore, it is prayed that the Board redetermine the correct de-
ficiency for the year 1928, even though the amount thereof be greater
than the deficiency determined by the Commissioner.

(Sgd.) C. M. CHAREST.
General Counsel, Bureau of Internal Revenue.

Of Counsel:
F. R. SHEARER,
Special Attorney, Bureau of Internal Revenue.

32 Before United States Board of Tax Appeals

Docket No. 56720. Promulgated August 24, 1937

PENNSYLVANIA WATER & POWER COMPANY, PETITIONER
v.
COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Opinion

Rendered August 24, 1937

1. Petitioner acquired all the assets of its wholly owned subsidiary
in consideration of the delivery to it of all the subsidiary's capital stock

and the assumption by it of all of the subsidiary's indebtedness. This was done under a Pennsylvania statute sometimes referred to as permitting a "short form of merger." Statute examined and held acquisition by petitioner of the assets of its subsidiary under the statute was a purchase and not a merger.

2. Petitioner retired bonds issued by its former subsidiary and deducted from its gross income, (a) the unamortized discount and expense incurred in the issuance of such bonds and (b) premium paid by it in the retirement of such bonds. Held, following Metropolitan Edison Co., 35 B. T. A. 10, that the premium paid by petitioner is deductible from its gross income but the unamortized discount and expenses are not.

Edwin M. Sturtevant, Esq., for the petitioner.

William E. Davis, Esq., for the respondent.

MELLOTT: The Commissioner disallowed several hundred thousand dollars, claimed by petitioner as deductions from its gross income in its return for the year 1928, and determined a deficiency in income tax against it for said year in the amount of $86,508.25. He concedes that he erred in disallowing $339,900.10 but contends that a deficiency of $39,675.82 exists by reason of the fact that $37,659.52 of the amount deducted by petitioner was improperly deducted and should be included in its taxable income. All of the facts were stipulated. We set out herein the portion of the stipulation especially pertinent to the issues raised.

1. Prior to 1924, petitioner generated all electricity sold by it exclusively by water power at its hydroelectric plant located on the Susquehanna River at Holtwood, Pennsylvania. The amount of electrical energy generated at Petitioner's hydroelectric plant varied from time to time due to changing river conditions. When the flow of the water in the Susquehanna River was high a maximum amount of electrical energy could be generated, and when the water was low, or ice had accumulated at the dam, the output of the plant was materially reduced. In order to supply Petitioner's customers with adequate and continuous service, and utilize the river flow to the best advantage, it became necessary to provide an auxiliary supply of electrical energy generated by steam.

2. Petitioner was advised by its counsel that it had no corporate powers to engage in the business of generating electricity by steam, and that it would be necessary to incorporate a subsidiary to carry on this activity. Accordingly, on August 9, 1924, Holtwood Power Company, hereinafter referred to as the "Holtwood Company," was incorporated under the laws of the Commonwealth of Pennsylvania, with an authorized capital of $1,500,000 consisting of 15,000 shares of the par value of $100 each. All of these shares were purchased by Petitioner, and 50 of the shares were placed in the names of seven directors in order to qualify them as directors, Petitioner, however, remaining the equitable owner of the said 50 shares. With

the funds paid by Petitioner to the Holtwood Company fo
34 the capital stock, and the proceeds received from the sale o
the bonds hereinafter mentioned, Holtwood Company erecte
the auxiliary steam-generating plant on a site immediately adjacen
to Petitioner's hydroelectric plant.

3. By an agreement between Petitioner and the Holtwood Com
pany, dated August 26, 1924, a copy of which is attached hereto a
"Exhibit No. 1," which agreement ran to January 1, 1975, Holtwoo
Company agreed to deliver to Petitioner, on its order, electric powe
up to the full capacity of the steam generating plant, and Pet
tioner agreed to pay, or provide for the payment, monthly of ever
obligation and expense of the Holtwood Company, and a net retur
of 8% annually upon the par value of all its securities at any tim
outstanding. Among the items enumerated in the agreement t
be paid by Petitioner were (1) "a sum to provide for amortizatio
of debt, discount, and security issue expense," and (2) "the expense
attending the issue, registration, and transfer of the capital stoc
and bonds * * * now or hereafter issued and outstanding, an
all interest on its bonded or other indebtedness at any time out
standing or existing, as and when said several interest payment
may become due and payable."

From the date of completion of the Holtwood Company's steam
plant on August 16, 1925, to the date of the consummation of th
"short form of merger," hereinafter mentioned, of the Holtwoo
Company into Petitioner (December 21, 1927), all the electric en
ergy generated at the steam plant was delivered to Petitioner
Petitioner's officers were officers of the Holtwood Company, and th
Holtwood Company, during its entire existence, was managed and
the steam plant operated by Petitioner's officers and employees. The
officers of the Holtwood Company did not receive any salaries from
that Company, and the said Company did not have any employees
Petitioner, however, increased the number of its employees in order
to operate the steam plant. The steam plant of the Holtwood Com
pany was operated only at such times as conditions of river flow
made it necessary for Petitioner to utilize an auxiliary supply of
electric energy. It was operated at all times as a department of
Petitioner.

35 4. For the purpose of providing part of the funds for the con-
struction of the steam power plant, Holtwood Company exe-
cuted a mortgage and deed of trust to the New York Trust Company,
Trustee, dated September 1, 1924, whereby it conveyed all of its prop-
erty to the said trustee for the purpose of securing bonds to be issued
under said deed of trust not in excess of $25,000,000 at any one time
outstanding. A copy of the said deed of trust is filed herewith, marked
"Exhibit No. 2." The deed of trust (page 15) provided that the bonds
might be issued in one or more series; that a series of bonds limited to
$2,750,000 in aggregate principal amount should be designated "Series
A" (page 16); that Series A bonds should be dated September 1, 1924

(page 17), should bear interest at the rate of six per centum (6%) per annum (page 16), should mature September 1, 1954 (page 16), and should be redeemable at the option of the Holtwood Company, as a whole or in any part, on any interest date prior to maturity at the principal amount thereof, together with a premium of seven per centum (7%) of the principal amount thereof in the case of bonds redeemed on or before September 1, 1929 (page 17), which premium was to be reduced one-fourth of one per cent. on March 1, 1930 and on the first day of March in each year thereafter until March 1, 1953, when the redemption price would be 101 per cent. (page 17).

5. Subsequent to the execution of the said deed of trust, the Holtwood Company sold to the public $2,750,000 par value of its Series A 6% First Mortgage Sinking Fund Gold Bonds, dated September 1, 1924, maturing September 1, 1954, and received therefor a cash consideration of $2,612,500.

6. The issuance of the Holtwood Bonds comprehended a financing cost of $162,749.87 represented by discount and expenses as follows:

Discount	$137,500.00
Expenses	25,249.87
Total	$162,749.87

36 7. This amount of $162,749.87 was set up on the books of the Holtwood Company as "Unamortized Bond Discount and Expense." Each year from 1924 to 1927, inclusive, the discount and expense was amortized on the books of the Holtwood Company by charging off an aliquot portion of the said discount and expense based on the life of the bonds.

8. The Holtwood Company had no income other than payments made to it by Petitioner pursuant to the agreement dated August 26, 1924, above referred to and filed herewith as "Exhibit No. 1."

9. Each year from 1924 to 1927, inclusive, a consolidated income tax return was filed for Petitioner and the Holtwood Company. In the said income tax returns the discount and expense, applicable to the Holtwood Bonds, was pro-rated or amortized by taking as deductions in each of said years an aliquot portion of the said discount and expense based on the life of the bonds.

The Petitioner was required by the agreement of August 26, 1924, to make payments to the Holtwood Company on account of the amortization of bond discount and expense, which payments were deductible from Petitioner's gross income as ordinary and necessary business expenses (cost of power), and the Holtwood Company reported these payments as income, which were offset by its deductions on account of amortization of discount and expense. The said agreement ran to January 1, 1975 and the Holtwood Bonds matured September 1, 1954.

10. After the incorporation of the Holtwood Company, Petitioner was advised by its counsel that Petitioner and the Holtwood Company could not consolidate or merge because they were not engaged

in similar businesses, since Petitioner had power to supply water
the public, which power the Holtwood Company did not possess. O
June 26, 1926, the Supreme Court of Pennsylvania, in the case of Yo
Haven Water and Power Co. et al. v. Public Service Commission
Pennsylvania et al., 287 Pa. 241, 134 Atl. 419, decided, und
37 similar facts, that such companies might consolidate or mar
provided the power to supply water be legally discarded. O
October 4, 1927, pursuant to the holding of the Court in that ca
Petitioner surrendered its corporate power to store, transport, a
supply water in accordance with the procedure prescribed by the co
poration law of Pennsylvania.

Thereafter a "short form of merger" of the Holtwood Compa
into Petitioner was effected under Section 23 of the Act of the Commo
wealth of Pennsylvania of April 29, 1874, as amended by Section 5
the Act of April 17, 1876, and the Act of June 2, 1915, a copy of whi
is filed herewith as "Exhibit No. 3." Pursuant to and in accordan
with the procedure prescribed by the said Act, as amended, Holtwo
Company, by deed dated December 21, 1927, transferred all its fra
chises and property, real, personal and mixed to Petitioner, the so
consideration for the transfer being the delivery to the Holtwo
Company of all its capital stock, and Petitioner assuming the indebte
ness of the Holtwood Company. Thereupon, pursuant to the pr
visions of the Act of 1874, as amended, Holtwood Company, b
operation of law ceased to exist. All the returns and certificat
relating to the said "short form of merger," required by the said A
to be filed, were duly filed in the Office of the Secretary of t
Commonwealth.

11. In determining the income tax liability of Petitioner and t
Holtwood Company for the year 1927, during which year the "sho
form of merger" of the Holtwood Company into Petitioner was co
summated, the said companies and the Respondent treated the sa
merger as a non-taxable transaction giving rise to no gain or loss.

12. On March 1, 1928, Petitioner sold to the public $6,000,000 p
value of its Series B 4½% Bonds, dated March 1, 1928, maturi
March 1, 1968.

13. The purpose of the issue of $6,000,000 par value of Petitioner
Series B 4½% Bonds was to apply the proceeds to the retirement
$3,000,000 of Petitioner's Series A 5½% Bonds and $2,750,000 p
value of Holtwood Bonds.

38 14. On March 1, 1928, pursuant to notice dated January 2
1928 (given by Petitioner as successor to the Holtwood Com
pany) duly published and mailed to holders of the Holtwood Bond
Petitioner retired for cash the $2,750,000 of Holtwood Bonds, payi
therefor par plus a premium of 7%, or $192,500. None of the Hol
wood Bonds were exchanged for Petitioner's Series B Bonds.

In retiring the Holtwood Bonds, Petitioner exercised the optio
originally reserved to the Holtwood Company in the deed of tru

under which the bonds were issued, to which Petitioner succeeded as a result of the "short form of merger."

15. On January 1, 1928, the year of the retirement of the Holtwood Bonds, the balance of discount and expense applicable to said bonds, which had not been amortized and deducted for income tax purposes, amounted to $145,159.52.

16. In its income tax returns for 1928 Petitioner claimed (among others) the following deductions:

Amortized portion of discount and expense applicable to Holtwood Bonds for the period January 1, 1928 to February 28, 1928	$904.42
Unamortized discount and expense on Holtwood Bonds	144,255.10
Premium paid in retirement of Holtwood Bonds	192,500.00
Total	337,659.52

The question, as stated by both parties upon brief, is—"Is petitioner entitled, as the successor of its wholly owned subsidiary, Holtwood Power Company, to deduct from gross income for the year 1928, (a) the unamortized discount and expense incurred in the issuance, and, (b) premium paid in the retirement of Holtwood Power Company Series A 6% First Mortgage Sinking Fund Gold bonds, dated September 1, 1924, and maturing September 1, 1954, which petitioner re-39 tired for cash on March 1, 1928, at par plus premium of 7% by the use of part of the proceeds of Petitioner's Series B 4½% bonds?" The portion of the question re...red to as (a) will be considered first.

Petitioner contends, and it is apparently conceded by respondent, that if the transaction by which the petitioner assumed the bonds of Holtwood Power Company constituted a merger or consolidation, then petitioner is entitled to deduct the unamortized discount and expense of issuing such bonds, which the parties have stipulated to be $144,255.10. This contention is sound and accords with the view frequently expressed by the courts and this Board. Western Maryland Railway Co. v. Commissioner, 33 Fed. (2d) 695; New York Central Railroad Co. v. Commissioner, 79 Fed. (2d) 247; Illinois Power & Light Corporation, 33 B. T. A. 1189; Metropolitan Edison Co., 35 B. T. A. 1110; Coast Counties Gas & Electric Co., 36 B. T. A.—(July 27, 1937). But if the transaction is a mere purchase or sale, the purchasing corporation is not entitled to the deduction. Turner-Farber-Love Co. v. Helvering, 68 Fed. (2d) 416; American Gas & Electric Co. v. Commissioner, 85 Fed. (2d) 527, affirming 33 B. T. A. 471; American Gas & Electric Co. v. United States, 17 Fed. Supp. 151; Metropolitan Edison Co., supra. (Issue IV.) It is therefore necessary to determine whether the transaction was a sale, as contended by the respondent, or a merger, as contended by the petitioner.

The instant proceeding is not distinguishable upon its facts from those in Metropolitan Edison Co., supra, bearing upon issue V. There, as here, there was a so-called "short form merger" under the

identical section of the Pennsylvania law now under consideration. The section reads as follows:

"Any corporation created under the provisions of this act
40 * * * may reduce its capital stock * * * by a vote of
the stockholders * * *; and it shall be lawful for any corporation in the same manner to sell, assign, dispose of, and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal, and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid * * *."

We said, in passing upon the issue in that case, that the "so-called merger * * * amounted in effect to a sale by the subsidiary of its assets to the parent corporation." We have reexamined the question in the light of the authorities cited by petitioner in its able brief but are not persuaded that we were wrong in the Metropolitan Edison case or that a different conclusion should be reached under the stipulated facts in this case. However, in view of the fact that our decision in the Metropolitan Edison case was promulgated subsequent to the filing of the briefs in the instant case, it will not be amiss to discuss some of the cases cited by petitioner.

Petitioner contends that the "short form merger" meets all the essential legal requirements of a merger, as defined by the Circuit Court of Appeals for the Second Circuit in Cortland Specialty Co. v. Commissioner, 60 Fed. (2d) 937, certiorari denied, 288 U. S. 599, including the requirement added in American Gas & Electric Co., supra. It relies especially upon the portion of the opinion in the Cortland Specialty case in which the court says that "A merger ordinarily is an absorption by one corporation of the properties and franchises of another whose stock it has acquired. The merged corporation ceases to exist and the merging corporations alone survive." While the definition was never intended to embrace all
situations which might arise, the court advisedly using the
41 word "ordinarily" and referring later in its opinion to the fact that the statutes of the states vary "in respect to how far the constituent companies may be deemed to survive the creation of the new or modified corporate structure," we are nevertheless constrained to hold that petitioner has not shown itself to be within that definition.

Petitioner contends that the opinion of the Supreme Court of Pennsylvania in Merwine v. Mt. Pocono Light & Improvement Co., 304 Pa. 517; 156 Atl. 150, "is a definite holding that a transfer by a corporation, under the procedure prescribed by the Act of 1876, as amended (shown supra), of its franchises and property to a corporation with which it is affiliated, under circumstances similar to those of the case at bar, is merely a formality and the transaction in reality is a merger of the two companies." While the court did say—though perhaps it was obiter dictum in view of the fact that it was not re-

quired to make any such determination—"that the transaction between the two corporations was in reality a merger," in the very next sentence it referred to the transferee corporation as "a purchaser cum onere" and instructed the personal injury plaintiff, in the event of judgment against the transferor corporation, "to levy where defendant's [transferor corporation] assets liable for the judgment may be found." It also held specifically that the transferor corporation had not "ceased to exist"—an essential under the definition petitioner is relying upon—saying:

"The statute of 1874 and its amendments plainly reveal that the words "shall cease to exist" primarily refer to a cessation of carrying on the business for which the selling corporation was created. * * * Defendant corporation [selling corporation] not having been legally dissolved, its present condition is rather that of an inactive cor-
42 poration and it is not altogether dead. Before a corporation has ceased to exist in the absolute sense here contended for, it must fully and definitely close its affairs, and the fact that a corporation has 'ceased to do business' does not preclude it from exercising its various rights to accomplish this purpose * * *.

The above holding accords with the views of the same court as expressed in Commonwealth v. Lumber City Water Co., 225 Pa. 317; 74 Atl. 238.

Petitioner also relies upon York Haven Water & Power Co. v. Public Service Commission of Pennsylvania, 287 Pa. 241; 134 Atl. 419. That case involved the question of the right of an electric light, heat, and power company to purchase or merge with a hydroelectric or water power company. The court in its opinion said:

"There are two forms of consolidation in Pennsylvania, a short and a long form merger. These are accomplished by the act of 1876, as amended, and the act of 1909. The act of April 17, 1876 (P. L. 33 [30]), as amended, provides that such sale may take place if the 'franchises are not inconsistent' with this act. And the Merger Act 1909 (P. L. 408; Pa. St. 1920, § 5748 et seq.) permits consolidation between corporations 'transacting the same or similar lines of business.'"

In a later decision, In re Buist's Estate, 297 Pa. 537; 147 Atl. 606, the court, considering and discussing whether the merger of a number of banking institutions into the Philadelphia National Bank under the act of Congress (November 7, 1918, ch. 209, § 1, 40 Stat. 1043, U. S. C. A., title 12, § 33) empowering national banks to consolidate, constituted a sale, liquidation, or a merger or consolidation of assets, stated as follows:

"* * * Care should be taken to distinguish consolidation from proceedings under the Act of April 17, 1876, P. L. 33 [30] § 5,
43 as amended (Pa. St. 1920, § 5694), often referred to as a 'short form merger' (See York Haven W. & P. Co. v. P. S. C., 287 Pa. 241, 134 A. 419); its operation in reality effects a sale of all the company's assets."

The new conception was not on the basis of sale, but of a merger or consolidation of assets, which is opposed to sale.

In a number of cases the Pennsylvania courts have referred to transactions under the act in question as being sales. See Koehler v. St. Mary's Brewing Co., 228 Pa. 628; 77 Atl. 1016; Greensburg Borough v. Westmoreland Water Co., 240 Pa. 481; 87 Atl. 995; Ringler v. Atlas Portland Cement Co., 301 Pa. 176; 151 Atl. 815. Thus in the last case cited, supra, the court refers to the act as regulating "the sale of franchises and assets of one Pennsylvania corporation to another, involving the dissolution of the selling corporation," while in a very recent case, In re Daily's Estate, 186 Atl. 754 (1936), the court, citing with approval the Buist Estate case, supra, holds that "a merger is not a sale or liquidation of corporate property but a consolidation of property, powers, and facilities."

It will be noted that the act authorizes a corporation "to sell, assign, dispose of and convey" its property. The stipulation shows that that is what occurred here. Holtwood, by deed, transferred all its franchises and property to petitioner, the sole consideration being the delivery to it of its capital stock and the assumption of its indebtedness. "The transaction certainly bore all the characteristics of a simple sale" (Cortland Specialty Co. v. Commissioner, supra), and we are still of the opinion, which we expressed in Metropolitan Edison Co., supra, that the so-called "short form merger" was, in effect, simply a sale by Holtwood of its assets to this petitioner. It follows that the respondent did not err in disallowing, as a deduction from petitioner's gross income, the unamortized discount and expense on the Holtwood bonds in the amount of $144,255.10.

44 Petitioner must prevail in so far as subdivision (b) of the question is concerned, though not upon the grounds urged in its brief. It is now settled that premiums paid by a parent corporation in the retirement of bonds issued by its subsidiary and assumed by it in a transfer of the assets of the subsidiary to it, are deductible from the gross income of the parent corporation, though a contrary view at one time prevailed. The question was recently considered by this Board in Metropolitan Edison Co., supra (issue III). Therein we reviewed the court and Board decisions and concluded that the reasoning under which a conclusion had been reached that such expenditures were not deductible was unsound and should no longer be followed. We pointed out that, while we thought they were deductible as ordinary and necessary expenses of carrying on a trade or business (section 23 (a), Revenue Act of 1928), if they were not properly so classified they were nevertheless deductible as losses (section 23 (e), Revenue Act of 1928). Such was the holding of the Court of Claims in American Gas & Electric Co. v. United States, 17 Fed. Supp. 151, which we thought and still think to be sound. The portion of our opinion in Coast Counties Gas & Electric Co., 33 B. T. A. 1119, holding that such premiums were not deductible, has now been set aside. Coast Counties Gas & Electric Co., 36 B. T. A. (July 27, 1937). The facts before

as in the instant proceeding clearly require that we reach, and we do reach, the same conclusion here.

It is therefore held that the respondent erred in disallowing the deduction from petitioner's gross income of the premium paid by it in retirement of the Holtwood Power Co. bonds, amounting to $192,500.

Deficiency shall be recomputed in accordance with the views herein expressed.

Judgment will be entered under Rule 50.

45 **Before United States Board of Tax Appeals**

Decision

Entered October 16, 1937

Pursuant to the Board's Opinion, promulgated August 24, 1937, the respondent herein having on October 4, 1937, filed a motion and recomputation of tax, and the petitioner herein having on October 9, 1937, filed an acquiescence in said recomputation, now, therefore, it is

Ordered and decided that there is a deficiency in income tax of $16,575.82 for the year 1928.

[SEAL] (Sgd.) EUGENE BLACK.
Member, U. S. Board of Tax Appeals.

In United States Circuit Court of Appeals

Petition for review

Filed December 22, 1937

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Third Circuit:

Your petitioner, Pennsylvania Water & Power Company, respectfully shows:

I. Jurisdiction for review

This is a proceeding for review by the United States Circuit Court of Appeals for the Third Circuit, pursuant to Sections 1001, 1002, and 1003 of the Revenue Act of 1926, as amended, of a decision of the United States Board of Tax Appeals, entered on the sixteenth day of October, 1937, and redetermining a deficiency in income taxes for the calendar year 1928 against your petitioner, in the amount of $16,575.82.

Your petitioner is a corporation organized under the laws of the State of Pennsylvania, having its corporate office at Holtwood, Pennsylvania.

46 For the calendar year 1928, petitioner made its income tax return to the Collector of Internal Revenue for the First District of Pennsylvania, whose office is located in the City of Philadelphia, State of Pennsylvania.

II. Nature of controversy

Petitioner operates a hydroelectric power plant located on the Susquehanna River at Holtwood, Pennsylvania. It owned all of the capital stock of Holtwood Power Company, which it organized for the purpose of constructing a steam power plant to be operated as an auxiliary to the hydro plant. Under a contract between the two companies, petitioner operated the steam plant with its own employees, received the entire output of the electric energy generated at the plant and was obligated to pay annually to the Holtwood Company an amount to cover all expenses, taxes, bond interest, bond discount, etc.

For the purpose of financing the building of the steam power plant the Holtwood Power Company sold to the public its Thirty-Year First Mortgage Bonds dated September 1, 1924. The bonds were sold at 95 and the discount of five points plus the expense incident to the issue amounted to $162,749.87. Both the Courts and the Commissioner of Internal Revenue consider such discount and expense to be in the nature of additional deferred interest on the bonds to be amortized over their life. If the bonds run for thirty years, as in this case, one-thirtieth of the discount and expense is deductible from gross income each year in arriving at taxable net income. If the bonds are retired before maturity by the issuing corporation, or by a corporation into which it is merged or with which it is consolidated, the unamortized discount and expense is deductible in its entirety for the year in which the bonds are retired.

47 On December 21, 1927, pursuant to the provisions of Section 23 of the Act of the Commonwealth of Pennsylvania of April 29, 1874, as amended by Section 5 of the Act of April 17, 1876, and the Act of June 2, 1915, the Holtwood Power Company transferred all its property as an entirety to petitioner and by operation of law ceased to exist.

On March 1, 1928, petitioner retired for cash the outstanding Holtwood Power Company bonds at par plus a premium of 7 per cent. In its income tax return for said year, petitioner claimed as deductions (1) the unamortized discount and expense on the bonds and (2) the 7 per cent. premium paid in connection with their retirement. The two deductions were disallowed by the Commissioner of Internal Revenue.

It was stipulated before the Board of Tax Appeals that if the Commissioner erred in disallowing the said two deductions, judgment should be entered for the petitioner in the amount of $843.32. The Board affirmed the action of the Commissioner of Internal Revenue in disallowing the deduction of unamortized discount and expense, but reversed the action of the Commissioner with respect to the premium and allowed it as a deduction.

The sole question here is whether the action of the Board of Tax Appeals in affirming the disallowance by the Commissioner of Internal Revenue of the deduction of the unamortized bond discount

and expense on the Holtwood Power Company bonds was proper under the law and the evidence.

Petitioner claims that the transfer to it of the property of the Holtwood Power Company, effected pursuant to the aforementioned statute, was a "merger" and also that the transaction involved only a change in the corporate form and not a change in substance. The Commissioner of Internal Revenue contended, and the Board
48 of Tax Appeals decided, that the transaction was a "sale," and, therefore, petitioner was not entitled to deduct the unamortized discount and expense.

III. Assignments of error

Your petitioner further shows that it is aggrieved by the action of said Board and injured thereby and that the errors complained of are as follows:

1. Said Board erred in basing its decision on the ground that the transaction effected on December 21, 1927, by petitioner and Holtwood Power Company, pursuant to the Act of the Commonwealth of Pennsylvania of April 29, 1874, as amended, was a sale of assets.

2. Said Board erred in the failure to find that the said transaction effected pursuant to the Act of the Commonwealth of Pennsylvania of April 29, 1874, as amended, was a "merger," or, in the alternative, that it was a corporate change in form only and not a change in substance.

3. Said Board erred in holding that petitioner was not entitled to deduct from its gross income for the year 1928 the amount of unamortized bond discount and expense applicable to the said Holtwood bonds.

4. Said Board erred in rendering judgment for the Commissioner of Internal Revenue in the amount of $16,575.82, whereas judgment should have been entered for the petitioner in the amount of $843.32.

Wherefore, your petitioner prays that this Court may review the decision of the United States Board of Tax Appeals in this cause, reverse the same and direct the said Board to allow as a deduction from petitioner's gross income for the year 1928 the amount of
49 unamortized bond discount and expense applicable to the Holtwood bonds, and enter judgment for the petitioner in the amount of $843.32; and that this Court may grant such other and further relief as may appear proper in the premises.

PENNSYLVANIA WATER & POWER COMPANY.
By J. A. WALLS, *President.*
CLYDE T. WARREN,
EDWIN M. STURTEVANT,
Attorneys for Petitioner.
1707 Lexington Building, Baltimore, Maryland.
[*Duly sworn to by J. A. Walls; jurat omitted in printing.*]

50 Before United States Board of Tax Appeals

Statement of evidence

Filed December 30, 1937

The above cause came on for hearing before the Honorable Arthur J. Mellott, Member of the United States Board of Tax Appeals, on the thirtieth day of November, 1936, there being present the petitioner and respondent by their respective counsel.

Thereupon, the cause was submitted upon stipulation of facts, together with certain exhibits. The substance of the stipulation, material and necessary to the determination of the assignments of error set out by petitioner in its petition for review by the United States Circuit Court of Appeals for the Third Circuit of the decision of the Board of Tax Appeals, is as follows:

Preliminary facts

1. Petitioner, Pennsylvania Water & Power Company, is a corporation duly organized and existing under the laws of the Commonwealth of Pennsylvania. Petitioner was incorporated on January 13, 1910, and at all times since its incorporation has maintained its principal office and place of business at Holtwood, Pennsylvania.

2. Petitioner owns and operates a hydroelectric plant located on the Susquehanna River at Holtwood, Pennsylvania, and a steam electric plant adjacent thereto.

3. Within the time specified by law, to wit, on March 12, 1929, petitioner, on behalf of itself and subsidiary corporations which were affiliated with it within the meaning of Section 142 of the Revenue Act of 1928, duly filed with the Collector of Internal Revenue at Philadelphia, Pennsylvania, a consolidated income tax return
51 (on form No. 1120) embracing the income and deductions of the said corporations for the calendar year 1928, disclosing an income tax liability of $174,805.88, and paid the said tax in four installments.

4. The books of petitioner at all times since its incorporation have been kept upon the accrual basis of accounting. All its Federal income tax returns have been filed in accordance with said basis for calendar years. The parties hereby stipulate and agree that said basis of accounting is proper.

5. On February 18, 1931, respondent sent to petitioner by registered mail a notice of deficiency in income tax for the calendar year 1928. A copy of said notice of deficiency, marked "Exhibit A," was filed with the petition herein and is hereby by reference incorporated herein.

Stipulation of facts in reference to Holtwood bonds

1. Prior to 1924 petitioner generated all electricity sold by it exclusively by water power at its hydroelectric plant located on

the Susquehanna River at Holtwood, Pennsylvania. The amount of electrical energy generated at petitioner's hydroelectric plant varied from time to time due to changing river conditions. When the flow of the water in the Susquehanna River was high a maximum amount of electrical energy could be generated, and when the water was low, or ice had accumulated at the dam, the output of the plant was materially reduced. In order to supply petitioner's customers with adequate and continuous service, and utilize the river flow to the best advantage, it became necessary to provide an auxiliary supply of electrical energy generated by steam.

2. Petitioner was advised by its counsel that it had no
52 corporate powers to engage in the business of generating electricity by steam, and that it would be necessary to incorporate a subsidiary to carry on this activity. Accordingly, on August 9, 1924, Holtwood Power Company, hereinafter referred to as the "Holtwood Company," was incorporated under the laws of the Commonwealth of Pennsylvania, with an authorized capital of $1,500,000 consisting of 15,000 shares of the par value of $100 each. All of these shares were purchased by petitioner, and 50 of the shares were placed in the names of seven directors in order to qualify them as directors, petitioner, however, remaining the equitable owner of the said 50 shares. With the funds paid by petitioner to the Holtwood Company for the capital stock, and the proceeds received from the sale of the bonds hereinafter mentioned, Holtwood Company erected the auxiliary steam generating plant on a site immediately adjacent to petitioner's hydroelectric plant.

3. By an agreement between petitioner and the Holtwood Company, dated August 26, 1924, a copy of which is attached hereto as "Exhibit No. 1," which agreement ran to January 1, 1975, Holtwood Company agreed to deliver to petitioner, on its order, electric power up to the full capacity of the steam generating plant, and petitioner agreed to pay, or provide for the payment, monthly of every obligation and expense of the Holtwood Company, and a net return of 8 per cent. annually upon the par value of all its securities at any time outstanding. Among the items enumerated in the agreement to be paid by petitioner were (1) "a sum to provide for amortization of debt, discount, and security issue expense," and (2) "the expenses attending the issue, registration, and transfer of the capital stock and bonds * * * now or hereafter issued and
53 outstanding, and all interest on its bonded or other indebtedness at any time outstanding or existing, as and when said several interest payments may become due and payable."

From the date of completion of the Holtwood Company's steam plant on August 16, 1925, to the date of the consummation of the "short form of merger," hereinafter mentioned, of the Holtwood Company into petitioner (December 21, 1927), all the electric energy generated at the steam plant was delivered to petitioner. Petitioner's officers were officers of the Holtwood Company, and the Holtwood Company, during its entire existence, was managed and the steam

plant operated by petitioner's officers and employees. The officers of the Holtwood Company did not receive any salaries from that Company and the said Company did not have any employees. Petitioner, however, increased the number of its employees in order to operate the steam plant. The steam plant of the Holtwood Company was operated only at such times as conditions of river flow made it necessary for petitioner to utilize an auxiliary supply of electric energy. It was operated at all times as a department of petitioner.

4. For the purpose of providing part of the funds for the construction of the steam power plant, Holtwood Company executed a mortgage and deed of trust to the New York Trust Company, Trustee, dated September 1, 1924, whereby it conveyed all its property to the said trustee for the purpose of securing bonds to be issued under said deed of trust not in excess of $25,000,000 at any one time outstanding. The deed of trust (page 15) provided that the bonds might be issued in one or more series; that a series of bonds limited to $2,750,000 in aggregate principal amount should be designated "Series A" (page 16); that Series A bonds should be dated September 1, 1924 (page 17), should bear interest at the rate of six per centum
54 (6%) per annum (page 16), should mature September 1, 1954 (page 16), and should be redeemable at the option of the Holtwood Company, as a whole or in any part, on any interest date prior to maturity at the principal amount thereof, together with a premium of seven per centum (7%) of the principal amount thereof in the case of bonds redeemed on or before September 1, 1929 (page 17), which premium was to be reduced one-fourth of one per cent. on March 1, 1930, and on the first day of March in each year thereafter until March 1, 1953, when the redemption price would be 101 per cent. (page 17).

5. Subsequent to the execution of the said deed of trust, the Holtwood Company *Company* sold to the public $2,750,000 par value of its Series A 6 Per Cent. First Mortgage Sinking Fund Gold Bonds, dated September 1, 1924, maturing September 1, 1954, and received therefor a cash consideration of $2,612,500.

6. The issuance of the Holtwood Bonds comprehended a financing cost of $162,749.87 represented by discount and expenses as follows:

Discount	$137,500.00
Expenses	25,249.87
Total	$162,749.87

7. This amount of $162,749.87 was set up on the books of the Holtwood Company as "Unamortized Bond Discount and Expense." Each year from 1924 to 1927, inclusive, the discount and expense was amortized on the books of the Holtwood Company by charging off an aliquot portion of the said discount and expense based on the life of the bonds.

8. The Holtwood Company had no income other than payments made to it by petitioner pursuant to the agreement dated August 26, 1924, above referred to and filed herewith as "Exhibit No. 1."
55 9. Each year from 1924 to 1927, inclusive, a consolidated income tax return was filed for petitioner and the Holtwood

Company. In the said income tax returns the discount and expense, applicable to the Holtwood Bonds, was pro-rated or amortized by taking as deductions in each of said years an aliquot portion of the said discount and expense based on the life of the bonds.

The petitioner was required by the agreement of August 26, 1924, to make payments to the Holtwood Company on account of the amortization of bond discount and expense, which payments were deductible from petitioner's gross income as ordinary and necessary business expenses (cost of power), and the Holtwood Company reported these payments as income, which were offset by its deductions on account of amortization of discount and expense. The said agreement ran to January 1, 1975 and the Holtwood Bonds matured September 1, 1964.

10. After the incorporation of the Holtwood Company, petitioner was advised by its counsel that petitioner and the Holtwood Company could not consolidate or merge because they were not engaged in similar businesses, since petitioner had power to supply water to the public, which power the Holtwood Company did not possess. On June 26, 1926, the Supreme Court of Pennsylvania, in the case of York Haven Water and Power Co. et al. v. Public Service Commission of Pennsylvania et al., 287 Pa. 241, 134 Atl. 419, decided, under similar facts, that such companies might consolidate or merge provided the power to supply water be legally discarded. On October 4, 1927, pursuant to the holding of the Court in that case, petitioner surrendered its corporate power to store, transport and supply water in accordance with the procedure prescribed by the corporation law of Pennsylvania.

Thereafter a "short form of merger" of the Holtwood Company into petitioner was effected under Section 23 of the Act of the Commonwealth of Pennsylvania of April 29, 1874, as amended by Section 5 of the Act of April 17, 1876, and the Act of June 2, 1915, a copy of which is filed herewith as "Exhibit No. 3." Pursuant to and in accordance with the procedure prescribed by the said Act, as amended, Holtwood Company, by deed dated December 21, 1927, transferred all its franchises and property, real, personal, and mixed to petitioner, the sole consideration for the transfer being the delivery to the Holtwood Company of all its capital stock, and petitioner assuming the indebtedness of the Holtwood Company. Thereupon, pursuant to the provisions of the Act of 1874, as amended, Holtwood Company, by operation of law, ceased to exist. All the returns and certificates relating to the said "short form of merger," required by the said Act to be filed, were duly filed in the Office of the Secretary of the Commonwealth.

11. In determining the income tax liability of petitioner and the Holtwood Company for the year 1927, during which year the "short form of merger" of the Holtwood Company into petitioner was consummated, the said companies and the respondent treated the said merger as a non-taxable transaction giving rise to no gain or loss.

12. On March 1, 1928, pursuant to notice dated January 27, 1928 (given by petitioner as successor to the Holtwood Company), duly published and mailed to holders of the Holtwood Bonds, petitioner retired for cash the $2,750,000 of Holtwood Bonds, paying therefor par plus a premium of 7 per cent., or $192,500.

57 In retiring the Holtwood Bonds, petitioner exercised the option, originally reserved to the Holtwood Company in the deed of trust under which the bonds were issued, to which petitioner succeeded as a result of the "short form of merger."

13. On January 1, 1928, the year of the retirement of the Holtwood Bonds, the balance of discount and expense applicable to said bonds, which had not been amortized and deducted for income tax purposes, amounted to $145,159.52.

14. In its income tax return for 1928 petitioner claimed (among others) the following deductions:

Amortized portion of discount and expense applicable to Holtwood Bonds for the period January 1, 1928 to February 28, 1928	$904.43
Unamortized discount and expense on Holtwood Bonds	144,255.10
Premium paid in retirement of Holtwood Bonds	192,500.00
Total	$337,659.53

15. The "Uniform Classification of Accounts for Electric Companies," prescribed by the Public Service Commission of Pennsylvania, which has been in force since January 1, 1919, contains the following provisions with reference to unamortized debt discount and expense:

"BALANCE SHEET ACCOUNTS

"UNAMORTIZED DEBT DISCOUNT AND EXPENSE

"Charge to this account all discounts and necessary expenses incurred in the issue by the utility of bonds and other evidences of indebtedness which mature more than one year from the date of their issue.

58 "By discount is meant the excess of the par value of such evidences of indebtedness, plus the interest accrued thereon at the time of their issue, over the actual cash value of the consideration received for them.

"Necessary expenses incurred in the issue of such evidences of indebtedness shall include fees for drafting mortgages and trust deeds, fees and taxes for recording mortgages and trust deeds, fees to trustees provided in mortgages and trust deeds, fees to underwriters and brokers for marketing such evidences of indebtedness, and other expenses of like character; the cost of engraving and printing bonds, certificates of indebtedness, and other commercial paper.

"*Discount on bonds and other evidences of indebtedness issued by others, and later assumed by the utility, shall be included in this account.* [Italics added.]

"At or before the close of each fiscal period, credit to this account and charge to '708. Amortization of Debt Discount and Expense' account, or to '296. Interest During Construction' account as provided

therein, a proportion of such discount and expense based upon the life of such evidences of indebtedness to date of maturity. Such discount and expense may, if desired, be amortized more rapidly through charges of all or any part of it, either at the time of issue or later, to '811. Other Deductions from Surplus' account."

"GROSS INCOME DEDUCTION ACCOUNTS

"AMORTIZATION DEDUCTIONS

"Amortization of Debt Discount and Expense—

"Charge, at or before the close of each fiscal period, to this account and credit to '130. Unamortized Debt Discount and Expense' account that proportion of the unextinguished discount and expense of the utility which is applicable thereto.

"The charge for each fiscal period shall be such an amount that it will, through regular application during the period from the date of the sale to the date of maturity of the evidences of indebtedness upon which the discount and expense was incurred, completely extinguish such discount and expense.

"The utility may amortize its debt discount and expense sooner by charging all or part of it, either at the time of the issue of the debt to which it applies or later, to '811. Other Deductions from Surplus' account.

"The records supporting the entries to this account shall be so kept that the utility can furnish information as to the amount of debt discount and expense charged to this account during each fiscal period for each class of its funded debt, the date of issue and maturity of the debt to which such discount applies, and the method whereby charges to this account are determined."

16. The following exhibits are filed herewith and constitute part of this stipulation:

No. 1.—Agreement between petitioner and the Holtwood Company dated August 26, 1924.

No. 3.—Copy of applicable sections of the Act of the Commonwealth of Pennsylvania of April 29, 1874, as amended by Section 5 of the Act of April 17, 1876, and the Act of June 2, 1915, under which the "short form of merger" was consummated.

No. 4.—Copy of the "Long Form Merger Act of 1909."

All statements and facts in Exhibit No. 1, attached hereto, shall be taken as true and correct, and such exhibit shall be given the same legal effect as though copied at length into this stipulation. Exhibits Nos. 3 and 4 are attached hereto for convenience only.

17. If the respondent erred in refusing to allow as deductions from gross income of the petitioner for the year 1928 the total amounts disallowed by him, as set forth in paragraph 14 hereof, there is an overpayment of petitioner's income tax for the year 1928 in the amount of $843.32.

The petitioner, Pennsylvania Water & Power Company, tenders and presents the foregoing as a statement of the evidence in this case and

prays that the same be approved by the United States Board of T
Appeals and made a part of the record in this cause.

CLYDE T. WARREN,
EDWIN M. STURTEVANT,
Attorneys for Petitioner.
1707 Lexington Bldg., Baltimore, Maryland.

Exhibit No. 1 to stipulation

This agreement, made this twenty-sixth day of August, A. D. 192 by and between Pennsylvania Water and Power Company, a corpor tion of the Commonwealth of Pennsylvania, hereinafter called "Powe Company" and Holtwood Power Company, a corporation of the Com monwealth of Pennsylvania, hereinafter called "Steam Company, witnesseth:

Whereas, the Steam Company has been organized for the purpose o producing and supplying steam generated electric energy.

And whereas, the Power Company is engaged in the generation and transmission of hydro-electric power derived from the water power o the Susquehanna River and has heretofore entered into contracts to deliver and sell electric power to certain public service companies.

61 And whereas, emergencies and shortages of power may occur whereby it will be difficult or impossible for the Power Company to supply sufficient power from its hydro-electric development to meet its contract requirements.

And whereas, the Power Company desires to protect itself, its customers and consumers who are dependent upon said customers against such emergencies and shortages, and as an incident of its business, cause to be provided for its customers power to supplement that derived from its hydro-electric development.

And now, in consideration of the premises, and of the mutual agreements hereinafter contained, it is agreed:

1. The Steam Company agrees to purchase and the Power Company agrees to sell and convey by such deeds of conveyance as the Steam Company or its counsel learned in the law shall advise, in fee simple, clear of all encumbrances, the following described tract of land:

(Here follows a description of the tract of land to be conveyed.)

The consideration or purchase price for said tract of land, rights and privileges shall be five thousand shares of the common capital stock of Holtwood Power Company, of the par value of Five Hundred Thousand Dollars ($500,000.00) which the Steam Company agrees to issue to the Power Company, upon delivery of a deed of conveyance for the property aforesaid, duly executed and acknowledged.

The Steam Company covenants and agrees that it will erect upon the premises aforesaid a steam power plant of such size and
62 capacity as may be approved by the Power Company, all to the end that the customers of the Power Company and the

consumers of the electrical energy supplied to said customers may be protected against the emergencies and shortages of power aforesaid and may obtain electric current necessary for their requirements.

2. The Steam Company agrees that (subject to its obligations as a public utility) it will deliver, on the order of the Power Company, electric power up to the full capacity of the Steam Company's plant.

3. The Power Company shall pay to Steam Company as compensation hereunder a sum sufficient to provide Steam Company the following:

(a) All costs of management, operation, and maintenance.

(b) An allowance for setting up depreciation, obsolescence, and renewal and replacement reserves or any of them in accordance with the standards accepted by the Pennsylvania Public Service Commission and agreed to by the parties hereto.

(c) A sum to provide for amortization of debt, discount, and security issue expense.

(d) A sum sufficient to provide a net return of eight per cent. annually upon the par value of its securities including its paid up stock.

(e) Payments to be made by Power Company under Section a, Paragraph 3 above, shall include any and all sums necessary for the purpose of defraying the expenses of maintaining the corporate organization of the Steam Company; the expenses attending the issuing, registration, and transfer of the capital stock and bonds of the Steam Company, now or hereafter issued and out-
63 standing, and all interest on its bonded or other indebtedness at any time outstanding or existing, as and when said several interest payments may become due and payable; sinking fund requirements of its first mortgage or other bonds, in accordance with the provisions of the mortgage or deed of trust securing such bonds; all Federal, State, Municipal, and other taxes, charges, licenses, and assessments, now or hereafter lawfully imposed upon the Steam Company or for which it may in any manner be liable or chargeable on account of its corporate existence, its franchises, property, real or personal, business, earnings, bonds, capital stock, dividends or profits, and any sum which shall hereafter be levied or assessed on any shareholder of the Steam Company or upon its share by way of direct tax upon said share or the income thereof, which the Steam Company shall or may be required to pay on behalf of or retain from any such shareholder or bondholder; all fire, storm, lightning, accident, compensation, public liability, or other insurance premiums which the Steam Company may be required or deem advisable to carry; all legal expenses and other expenses whatsoever from time to time as the same may arise not otherwise specifically covered by the terms of this agreement. The intent and purpose of these provisions being that the Power Company shall at all times pay or provide for the payment of every obligation and expense of the Steam Company in order to enable

the latter to realize a net return of eight per cent. annually upon the par value of all of its securities at any time outstanding.

4. The Power Company shall make monthly cash settlements on the 20th day of each month for the accrued indebtedness of the preceding month.

5. This agreement shall continue until January 1, 1975.

64 6. In order to make necessary repairs or changes on its system, Steam Company shall have the right temporarily to discontinue service but except in cases of extreme emergency, at least twenty-four hours' notice shall be given by Steam Company that discontinuance of service is to take place.

7. It is agreed that neither of the parties hereto assumes any obligation inconsistent with any law of the Commonwealth of Pennsylvania now or hereafter in force, and that compliance by either party with any lawful order of any commission or other governmental body having jurisdiction in the premises shall in no event be deemed a breach of this contract.

8. The provisions hereof shall bind and enure to the benefit of the parties hereto and their respective successors and assigns.

IN WITNESS WHEREOF, the parties have caused these presents to be executed by their duly authorized officers and their corporate seals to be affixed, the day and year first above mentioned.

PENNSYLVANIA WATER AND POWER COMPANY.
By (Sgd.) CHARLES E. F. CLARKE, *President.*

Attest:

(Sgd.) F. J. ALLEN, *Secretary.*

Witnesses present:

(Sgd.) E. V. ILLMER.
(Sgd.) OTTO C. W. KOPPLEMANN.

65

HOLTWOOD POWER COMPANY.
By (Sgd.) KERSEY CARRIGAN,
President.

Attest:

(Sgd.) JOHN S. GRAYBILL, JR., *Secretary.*
(Sgd.) J. GUY ESHLEMAN.
(Sgd.) ALICE G. SAUER.

Exhibit No. 3 to stipulation

COPY OF APPLICABLE SECTIONS OF THE ACT OF THE COMMONWEALTH OF PENNSYLVANIA OF APRIL 29, 1874, AS AMENDED BY SECTION 5 OF THE ACT OF APRIL 17, 1876, AND THE ACT OF JUNE 2, 1915, UNDER WHICH THE "SHORT FORM OF MERGER" WAS CONSUMMATED

SECTION 18. The capital stock or indebtedness of any corporation to be created under the provisions of this statute, or accepting its provisions, may be increased, from time to time, by the consent of the

persons or bodies corporate holding the larger amount in value of the stock of such company, to such amount as such corporation is by this act authorized to increase its capital stock or indebtedness, but such increase shall only be made for money, labor done, or money or property actually received.

SECTION 19. Any such corporation desirous of increasing its capital stock or indebtedness as provided by this act, shall, by a resolution of its board of directors, call a meeting of its stockholders therefor, which meeting shall be held at its chief office or place of business in this commonwealth; and notice of the time, place, and object of said meeting, shall be published once a week for sixty days prior to such meeting, in at least one newspaper published in the county, city, or borough wherein such office or place of business is situate.

SECTION 20. At the meeting called, pursuant to the nineteenth section of this act, an election of the stockholders of such corporation shall be taken for or against such increase, which shall be conducted by three judges, stockholders of said corporation, appointed by the board of directors to hold said election, and if one or more of said judges be absent, the judge or judges present shall appoint a judge or judges, who shall act in the place of the judge or judges absent, and who shall respectively take and subscribe an oath or affirmation before an officer authorized by law to administer the same, well and truly, and according to law, to conduct such election to the best of their ability; and the said judges shall decide upon the qualification of voters, and when the election is closed count the number of shares voted for and against such increase, and declare whether the persons or bodies corporate holding the larger amount of the stock of such corporation have consented to such increase, or refused to consent thereto, and shall make out duplicate returns of said election, stating the number of shares of stock that voted for such increase and the number that voted against such increase, and subscribe and deliver the same to one of the chief officers of said company.

SECTION 21. Each ballot shall have endorsed thereon the number of shares thereby represented, and be signed by the holder thereof, or by the person holding a proxy therefor; but no share or shares transferred within sixty days shall entitle the holder or holders thereof to vote at such election or meeting, nor shall any proxy be received, or entitle the holder to vote, unless the same shall bear date and have been executed within three months next preceding such election or meeting; and it shall be the duty of such corporation to furnish the judges at said meeting with a statement of the amount of its capital stock, with the names of persons or bodies corporate holding the same, and number of shares by each respectively held, which statement shall be signed by one of the chief officers of such corporation, with an affidavit thereto annexed

that the same is true and correct to the best of his knowledge a belief.

SECTION 22. It shall be the duty of such corporation, if consent given to such increase, to file in the office of the secretary of the co monwealth, within thirty days after such election or meeting, of the copies of the return of such election provided for by twentieth section of this act, with a copy of the resolution and not calling same thereto annexed; and upon the increase of the capi stock or indebtedness of such corporation made pursuant thereto shall be the duty of the president or treasurer of such corporati within thirty days thereafter, to make a return to the secretary of commonwealth, under oath, of the amount of such increase and ter of the same, that is to say, the terms on which additional stock issued; and in case of neglect or omission so to do, the corporat shall be subject to a penalty of five thousand dollars, which pena shall be collected on an account settled by the auditor general state treasurer, as accounts for taxes due the commonwealth are sett and collected; and the secretary of the commonwealth shall ca said returns to be recorded in a book to be kept for that purpose. furnish a certified copy of the same to the auditor general, and corporation shall have the right to recover the same from the of neglecting or omitting to file the return as aforesaid.

68 SECTION 23. Any corporation created under the provisi of this act, and any corporation of the classes named in second section hereof, that is now in existence by virtue of any of this Commonwealth, may reduce its capital stock or alter change the par value of the shares thereof, by a vote of the st holders taken in the manner and under the regulations prescribed the eighteenth, nineteenth, twentieth, twenty-first, and twenty-sec sections of this act; and it shall be lawful for any corporation in same manner to sell, assign, dispose of, and convey to any corporat created under or accepting the provisions of this act, its franchi and all its property, real, personal, and mixed, and thereafter s corporation shall cease to exist, and the said property and franch not inconsistent with this act, shall thereafter be vested in the poration so purchasing as aforesaid: Provided, That the returns quired by said section shall not be filed in the office of the Secret of the Commonwealth until each and every corporation, so sell assigning, disposing, and conveying such franchises and prope shall have filed with the Secretary of the Commonwealth a certifi from the Auditor General of the Commonwealth, setting forth all reports required by the Auditor General of the Commonwe have been duly filed to the date of the proposed sale, assignm disposition, and conveyance; and that all taxes due the Comm wealth of Pennsylvania have been paid up to and including date. (Act of April 29, 1874, Section 23, as amended by Act April 17, 1876, Section 5, and Act of June 2, 1915.)

69 *Exhibit No. 4 to stipulation*

Copy of Long Form Merger Act of 1909

(Purdon's Pennsylvania Statutes, Title 15)

Section 421. Merger authorized; exceptions; exclusive franchise not extended; merger subject to act of 1907

It shall be lawful for any corporation, now or hereafter organized under the provisions of any general or special act of Assembly authorizing the formation of any corporation or corporations, to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation into which such merger shall be made: Provided, That nothing in this act shall be construed so as to permit railroad, canal, or telegraph companies, which own, operate, or in any way control, parallel or competing roads, canals, or lines, to merge or combine: Provided further, That nothing in this act contained shall extend or enlarge beyond its former territorial limits the exclusive franchise of any gas or water company; and that the merger or consolidation of water companies shall be subject to the provisions of the act, entitled "An act to require all water and water-power companies hereafter incorporated, or hereafter formed by merger and consolidation, or hereafter purchasing property and franchises of any other such company, to designate the exact source of their supply of water or water-power; and to require all existing water and water-power companies, merging and consolidating or purchasing the property and franchises of any other such company, to accept the provisions of this act, and of the act approved April thirteenth, one thousand nine hundred and five, entitled 'An act providing that the right of eminent domain, as represents the appropriation of streams, rivers, or waters, or the land covered thereby, shall not be exercised by water companies incorporated under law,' and providing the manner in which water and water-power companies, subject to the provisions of this act, may secure a new or additional source of supply for their water or water-power," approved the seventh day of June, Anno Domini one thousand nine hundred and seven. (1909, May 3, P. L. 68, Section 1.)

Section 422. Procedure; joint agreement; approval by stockholder; certificates; approval by governor

Said merger or consolidation shall be made under the conditions, provisions, and restrictions, and with the powers herein set forth; to wit—

First. The directors of each corporation shall enter into a joint agreement, under the corporate seal of each corporation, for the

merger and consolidation of said corporations; prescribing the terms and conditions thereof, the mode of carrying the same into effect, the name of the new corporation, the number and names of the directors and other officers thereof, and who shall be the first directors and officers, and their places of residence, the number of shares of the capital stock, the amount or par value of each share, and the manner of converting the capital stock of each of said corporations into the stock of the new corporation, and how and when directors and officers shall be chosen, with such other details as they shall
71 deem necessary to perfect the said consolidation and merger; but said agreement shall not be effective unless the same shall be approved by the stockholders of said corporations, in the manner hereinafter provided.

Second. Said agreement shall be submitted to the stockholders of each of said corporations, at separate special meetings or at any annual meetings, of the time, place, and object of which respective meetings due notice shall be given by publication, once a week for two consecutive weeks before said respective meetings, in at least one newspaper in the county or in each of the counties in which the principal office of said respective corporations shall be situate—excepting in the case of the merger or consolidation of corporations which, upon their original incorporation, are required by the Constitution to publish notice of intention to incorporate for a longer period than two weeks, in which case notice by publication shall be as required by the Constitution—and at said meetings the said agreement of the directors shall be considered, and a vote of the stockholders in person or by proxy shall be taken, by ballot, for the adoption or rejection of the same, each share of stock entitling the holder thereof to one vote; and if a majority in amount of the entire capital stock of each of said corporations shall vote in favor of said agreement, merger, and consolidation, then that fact shall be certified by the secretary of each corporation, under the corporate seal thereof, and said certificates, together with the said agreement or a copy thereof, shall be filed in the office of the Secretary of the Commonwealth, who shall forthwith present the same to the Governor for his approval, and when approved by the Governor the said agreement shall be deemed and taken to be the act of consolidation of said corporation. (1909, May 3, P. L. 408, Section 2.)

72 Section 423. Effect of merger; new patent, bonus, certificate of reports and payment of taxes

Upon the filing of said certificates and agreement, or copy of the agreement, in the office of the Secretary of the Commonwealth, and upon the issuing of new letters patent thereon by the Governor, the said merger shall be deemed to have taken place, and the said corporations to be one corporation under the name adopted in and by said agreement possessing all the rights, privileges, and franchises

theretofore vested in each of them; and all the estate and property, real and personal, and rights of action, of each of said corporations, shall be deemed and taken to be transferred to and vested in the said new corporation, without any further act or deed: Provided, That all rights of creditors and all liens upon the property of each of said corporations shall continue unimpaired, limited in lien to the property affected by such liens at the time of the creation of the same, and the respective constituent corporations may be deemed to be in existence to preserve the same; and all debts not of record, duties, and liabilities of each of said constituent corporations shall thenceforth attach to the said new corporation, and may be enforced against it to the same extent and by the same process as if said debts, duties, and liabilities had been contracted by it. But such merger and consolidation shall not be complete, and no such consolidated corporation shall do any business of any kind, until it shall have first obtained from the Governor of the Commonwealth new letters patent, and shall have paid to the State Treasurer a bonus, as prescribed by law, upon all its capital stock in excess of the amount of capital stock of the several corporations so consolidating, upon
73 which the bonus required by law has been theretofore paid:

And provided further, That new letters patent of such consolidated corporation shall not be issued by the Governor of the Commonwealth, until each corporation entering into and forming the consolidated corporation shall have filed with the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth, setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed merger, and that all taxes due the Commonwealth of Pennsylvania have been paid, up to and including said date. (1909, May 3, P. L. 408, Section 3; 1915, April 29, P. L. 205, Section 1.)

Section 424. Evidence of merger

A certified copy of said certificate and agreement, or copy of agreement, so to be filed in the office of the Secretary of the Commonwealth, shall be evidence of the lawful holding and action of such meetings, and of the merger and consolidation of said corporations. (1909, May 3, P. L. 408, Section 4.)

Section 425. Dissenting stockholders; appraisement of damages and value of stock; payment

If any stockholder or stockholders of any corporation, which shall become a party to an agreement of merger and consolidation hereunder, shall be dissatisfied with or object to such consolidation, and shall have voted against the same at the stockholder's meeting, it shall and may be lawful for any such stockholder or stockholders, within thirty days after the adoption of said agreement of merger and consolidation by the stockholders, as herein provided, and upon reasonable notice to said corporation, to apply by petition to any

court of common pleas of the county in which the chief
74 office of such corporation may be situate, or to a judge of said
court in vacation, if no such court sits during said period, to appoint three disinterested persons to estimate and appraise the damages, if any, done to such stockholder or stockholders by said consolidation. Upon such petition, it shall be the duty of a said court or judge to make such appointment; and the award of the persons so appointed, or of a majority of them, when confirmed by the said court shall be final and conclusive; and the persons so appointed shall also appraise the share or shares of said stockholders, in the said corporation, at the full market value thereof, without regard to any appreciation or depreciation in consequence of the said consolidation; which appraisement, when confirmed by the said court, shall be final and conclusive; and the said corporation may, at its election, either pay to the said stockholder or stockholders the amount of damages so found and awarded, if any, or the value of the stock so ascertained and upon the payment of the value of the stock, as aforesaid, the said stockholder or stockholders shall transfer the stock so held by them to the said corporation, to be disposed of by the directors thereof or to be retained for the benefit of the other stockholders; and in case the value of said stock, as aforesaid, shall not be so paid within thirty days after the said award shall have been confirmed by said court, the damages so found and confirmed shall be a judgment against said corporation, and may be collected as other judgments in said court are by law recoverable. (1909, May 3, P. L. 40 Section 5.)

75 Before United States Board of Tax Appeals

Agreement to statement of evidence under equity rule 75

We have examined and read the foregoing 24 pages comprising the evidence taken in the case of Pennsylvania Water & Power Company, Petitioner, v. Commissioner of Internal Revenue, Respondent Docket No. 56720, in the United States Board of Tax Appeals; said evidence being stated in simple and condensed form, all parts not essential to the decision of the questions presented by the petition for review being omitted. We agree that all parties hereto have received due and legal notice of said statement as required by Equity Rule No. 75, and we accept service of such notice and hereby waive further notice of the filing of the statement, and we agree that said statement as made may be approved by the Board Member hearing the case without further notice to any party hereto, and that when so approved may be filed in the Clerk's office and become a part of the record for the purpose of the petition for review in said cause filed by Pennsylvania Water & Power Company, Petitioner.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue,
Attorney for Respondent

Dated: December 29, 1937.

76 Before United States Board of Tax Appeals

Order approving statement of evidence

I hereby certify that the foregoing statement of evidence has been examined by me and found conformable to the truth and contains all the evidence in said case in condensed form, and the proceedings had upon the trial of said cause.

It further appearing to the Board that Exhibit No. 1, entitled "Agreement between Pennsylvania Water & Power Company and Holtwood Power Company," dated August 26, 1924, referred to in the statement of evidence and incorporated therein by reference, is only partially pertinent to the issue involved in this appeal, it is hereby ordered that the description of the property to be conveyed contained therein, be omitted in preparing the transcript of the record herein.

Said statement of evidence on the petition for review of Pennsylvania Water & Power Company is hereby approved, signed, and ordered to be made of record in the above entitled cause this thirtieth day of December 1937.

(Sgd.) ARTHUR J. MELLOTT,
Member, United States Board of Tax Appeals.

77 Before United States Board of Tax Appeals

Praecipe for transcript of record

Filed December 29, 1937

To the Clerk of the United States Board of Tax Appeals:

Please prepare a transcript of record in this cause, and on or before the nineteenth day of February 1938 transmit the same to the Clerk of the United States Circuit Court of Appeals for the Third Circuit, and include in said transcript copies, duly certified as correct, of the following documents:

1. Docket entries of proceedings before the Board in the above entitled cause;
2. Petition for redetermination, filed with the Board by petitioner on April 18, 1931;
3. Notice of deficiency, filed with petition, marked Exhibit "A";
4. Answer to petition, filed on October 17, 1931;
5. Opinion of the Board promulgated on August 24, 1937;
6. Decision of the Board entered on October 16, 1937;
7. Petition for review, filed December 22, 1937;
8. Statement of evidence, approved and filed;
9. This praecipe for transcript.

In addition to the foregoing documents, please include and transmit with the statement of evidence and transcript the following

exhibits filed in the Board with the Stipulation of Facts in this cau
pursuant to the Board's order on the statement of evidence:

78 No. 1. Agreement between petitioner and Holtwood Pow
Company, dated August 26, 1924, omitting description of pro
erty to be conveyed;

No. 3. Copy of sections of the Act of the Commonwealth of Pen
sylvania of April 29, 1874, as amended by Section 5 of the Act
April 17, 1876, and the Act of June 2, 1915, under which the "sho
form of merger" was consummated;

No. 4. Copy of the "Long Form Merger Act of 1909."

Said transcript to be prepared as required by law and the rul
of the United States Circuit Court of Appeals for the Third Circu

AGREEMENT OF PRAECIPE

We hereby agree that the above and foregoing praecipe is correc
that the records, documents, papers, and proceedings therein set for
are sufficient for a complete record in this cause on appeal, and
hereby adopt the foregoing as a list designated by each of the parti
to this cause to complete said transcript, and we hereby waive th
issuance and service of notice upon any party hereto, and agree th
said praecipe shall be obeyed by, and acted upon by, the Clerk
fully and to all intents and purposes as if said praecipe had be
regularly filed and a true copy thereof served upon each party here

CLYDE T. WARREN,
EDWIN M. STUETEVANT,
Attorneys for Petitioner.
J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.
Attorney for Respondent.

79 [Clerk's certificate to foregoing transcript omitted
printing.]

80 In United States Circuit Court of Appeals for the Third
Circuit

No. 6678. March Term, 1938

PENNSYLVANIA WATER AND POWER CO., PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Order assigning judge

Filed April 11, 1938

And now, to-wit: this 11th day of April, A. D. 1938, it is order
that Hon. Oliver B. Dickinson, District Judge for the Eastern D

trict of Pennsylvania, be, and he is hereby, assigned to sit in above case in order to make a full court.

JOSEPH BUFFINGTON,
Circuit Judge.

[File endorsement omitted.]

In United States Circuit Court of Appeals for the Third Circuit

[Title omitted.]

Minute entry of argument

And afterwards, to wit, the 11th day of April 1938, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable J. Warren Davis and Honorable John Biggs, Jr., Circuit Judges, and Honorable Oliver B. Dickinson, District Judge, and the Court not being fully advised in the premises, takes further time for the consideration thereof.

And afterwards, to wit, on the 23d day of August 1938, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

In United States Circuit Court of Appeals, for the Third Circuit

No. 6678. March Term, 1938

PENNSYLVANIA WATER AND POWER COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review from the United States Board of Tax Appeals

Opinion

Filed August 23, 1938

Before DAVIS and BIGGS, Circuit Judges, and DICKINSON, District Judge.

DAVIS, Circuit Judge. The sole question here at issue is whether or not a parent corporation, having taken over the assets of its subsidiary corporation under the provisions of the so-called "short form merger statute" of Pennsylvania (Purdon's Pennsylvania Statutes, Title 15, Section 595), and thereafter, in 1928, having redeemed for cash bonds issued by the subsidiary, is entitled to deduct from its income tax return for that year the amount of the unamortized discount and expenses connected with the issuance of the bonds.

In the case of Metropolitan Edison Company v. Commissioner, which we are filing with this opinion, we held that the deduction was allowable. The decision in that case is applicable to the facts in this case.

Prior to October 4, 1927, the petitioner was authorized by
charter: (1) to store, transport and supply water, and (2) to p
duce and sell electricity generated by water power. It was inform
however, that it lacked the power to generate electricity by means
steam. At various times of the year, such as, when the river w
blocked by ice or the water was low, the petitioner's hydroelect
plant was incapable of producing sufficient electricity for its nee

In order to have on hand an added source of electrical power d
ing those periods, it formed the Holtwood Company, hereinaf
referred to as Holtwood, for the purpose of owning and operati
a steam power plant. Holtwood and the petitioner thereupon ente
into a contract under the terms of which the petitioner agreed
convey to Holtwood a tract of land adjacent petitioner's hydroel
tric plant, and Holtwood agreed to erect thereon a steam power pl
according to specifications acceptable to the petitioner. Holtwo
also contracted to sell to the petitioner all of the electricity produc
at such plant, in consideration of which the petitioner promised
pay as follows:

"* * * any and all sums necessary for the purpose of defrayi
the expenses of maintaining the corporate organization of the Ste
Company; the expenses attending the issuing, registration, and tra
fer of the capital stock and bonds of the Steam Company, now
hereafter issued and outstanding, and all interest on its bonded
other indebtedness at any time outstanding or existing, as and wh
said several interest payments may become due and payable; sinki
fund requirements of its first mortgage or other bonds, in
84 cordance with the provisions of the mortgage or deed of tr
securing such bonds; all Federal, State, Municipal and oth
taxes, charges, licenses, and assessments, now or hereafter lawfu
imposed upon the Steam Company or for which it may in any ma
ner be liable or chargeable on account of its corporate existence,
franchises, property, real or personal, business, earnings, bonds, c
ital stock, dividends or profits, and any sum which shall hereafter
levied or assessed on any shareholder of the Steam Company or up
its share by way of direct tax upon said share or the income there
which the Steam Company shall or may be required to pay on beh
of or retain from any such shareholder or bondholder; all fire, stor
lightning, accident, compensation, public liability, or other insura
premiums which the Steam Company may be required or deem adv
able to carry; all legal expenses and other expenses whatsoever fr
time to time as the same may arise not otherwise specifically cove
by the terms of this agreement. The intent and purpose of th
provisions being that the Power Company shall at all times pay
provide for the payment of every obligation and expense of t
Steam Company in order to enable the latter to realize a net retu
of eight per cent. annually upon the par value of all of its securit
at any time outstanding."

Holtwood issued 15,000 shares of capital stock, 14,950 of whi
were purchased by the petitioner in its own name. The petitio

also acquired equitable title to the remaining 50 shares, but they were placed in the names of other persons to qualify them as directors. Holtwood also issued bonds to the amount of $2,750,000. The discount on these bonds amounted to $137,500 and the expenses connected with the issue totaled $25,249.87. With the proceeds of the sale of all of its stock and bonds, Holtwood erected the steam power plant as agreed.

This plant was operated only during those periods when the
85 petitioner's hydroelectric plant could not produce sufficient electric power to supply its needs, and then it was operated by the petitioner, as Holtwood employed no men for this purpose. The officers and directors of the petitioner were made the officers and directors of Holtwood and all of the compensation received by them came from the petitioner.

The provision in the petitioner's charter empowering it to store, transport and supply water, was held to be a bar to a merger between the two companies. On June 6, 1926, the Supreme Court of Pennsylvania in the case of York Haven Water & Power Co. v. Public Service Commission (287 Pa. 241, 134 Atl. 419), under similar facts, held that if the power to supply water was legally abandoned, the merger could take place. In accordance with this decision, on October 4, 1927, the petitioner surrendered this power and shortly thereafter in 1927 it took over all of the assets of Holtwood under the "short form merger statute" of Pennsylvania. Under this statute, Holtwood conveyed all of its assets to the petitioner and the petitioner returned to Holtwood all of its stock and assumed all of its liabilities.

In 1928, the petitioner redeemed for cash all of the outstanding bonds issued by Holtwood. At that time there was $144,255.10 of the bond discount and issuing expenses still unamortized. In its income-tax return for that year, the petitioner deducted that amount. The commissioner, however, disallowed this deduction and determined a deficiency of $16,575.82. The United States Board of Tax Appeals sustained the commissioner's determination and the petitioner appealed to this court.

The sole question at issue is whether or not the petitioner was entitled to the deduction. This question depends upon whether or not the method by which the petitioner took over the assets of
86 Holtwood amounted to a merger or to a sale. If the transaction was a merger, the deduction should have been allowed. If it was a sale, it should not have been allowed.

As stated above, the decision in Metropolitan Edison Company v. Commissioner, supra, controls this case and the order of redetermination is set aside and the case remanded to the Board with directions to allow the deduction.

A true Copy:
Teste:

Clerk of the United States Circuit Court
of Appeals for the Third Circuit.

87 In United States Circuit Court of Appeals for the Third Circuit

No. 6678. March Term, 1938

PENNSYLVANIA WATER & POWER CO., PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment

Filed August 23, 1938

Appeal from the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order or decree of the said Board of Tax Appeals in this cause be, and the same is hereby reversed, with directions to the said Board of Tax Appeals to redetermine the tax of the petitioner in accordance with the opinion of this Court.

Philadelphia, August 23, 1938.

J. WARREN DAVIS,
Circuit Judge.

[File endorsement omitted.]

88 [Clerk's Certificate to foregoing transcript omitted in printing.]

89 Supreme Court of the United States

Order allowing certiorari

Filed January 3, 1939

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[Endorsement on cover:] File No. 42971, 42972. U. S. Circuit Court of Appeals, Third Circuit. Term No. 487. Guy T. Helvering, Commissioner of Internal Revenue, Petitioner vs. Pennsylvania Water & Power Company. Petition for writs of certiorari and exhibits thereto. Filed November 23, 1938. Term No. 486 O. T. 1938, 487 O. T. 1938.

U. S. GOVERNMENT PRINTING OFFICE 19

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FILED
NOV 28 1936

Nos. 486 and 487

In the Supreme Court of the United States

October Term, 1936

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

METROPOLITAN EDISON COMPANY

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

PENNSYLVANIA WATER & POWER COMPANY

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 486

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

METROPOLITAN EDISON COMPANY

No. 487

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

PENNSYLVANIA WATER & POWER COMPANY

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that writs of certiorari issue to review the judgments of the Circuit Court of Appeals for the Third Circuit entered in the above causes on August 23, 1938, reversing the decisions of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals in the *Metropolitan Edison Company* case (R. 59–83) is reported in 35 B. T. A. 1110, and that of the Circuit Court of Appeals (R. 95–100) is reported in 98 F. (2d) 807. The opinion of the Board of Tax Appeals in the *Pennsylvania Water & Power Company* case (R. 32–44) is reported in 36 B. T. A. 467, and that of the Circuit Court of Appeals (R. 82–84) is reported in 98 F. (2d) 812.

JURISDICTION

The judgments of the Circuit Court of Appeals in the two cases were entered August 23, 1938. (*Metropolitan Edison* case, R. 100; *Pennsylvania Water* case, R. 84–85.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.[1]

QUESTIONS PRESENTED

1. The taxpayer, a Pennsylvania corporation, acquired all of the assets of its wholly owned subsidiary in consideration of the delivery to the sub-

[1] The two cases were not consolidated, either before the Board or the Circuit Court of Appeals, but both tribunals recognized that the two cases presented similar questions and the Circuit Court of Appeals decided the *Pennsylvania Water & Power Company* case upon the authority of the *Metropolitan Edison Company* case, and entered its judgments in the two cases on the same day. For that reason, we are filing a single petition for writs of certiorari.

iary of all of the subsidiary's capital stock and
e assumption by the taxpayer of all of the sub-
iary's indebtedness. This transaction was car-
d out in accordance with Section 595, Title 15,
rdon's Pennsylvania Statutes, *infra*. The tax-
yer, the parent company, retired bonds issued at
liscount by its former subsidiary. Is the tax-
yer entitled to deduct from its gross income the
amortized bond discount and expense in the year
the retirement of the bonds?

2. The facts are the same as in Question 1, ex-
ot that the transaction was not carried out under
y Pennsylvania statute and the subsidiary was
immediately dissolved. Is the taxpayer en-
ed to deduct the unamortized bond discount and
pense in the year of the retirement of the
nds?[2]

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be
nd in Appendices A and B, *infra*, pp. 21–30.

STATEMENT

The facts in these cases are not in dispute and
found by the Board of Tax Appeals are sub-
ntially as follows:

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[2] The first question is presented in both cases. The *Metro-
tan Edison Company* case presents also the second
stion.

METROPOLITAN EDISON CASE

The taxpayer, the Metropolitan Edison Company, is a Pennsylvania corporation which in 1927 and 1928 filed consolidated returns in behalf of itself and its subsidiaries. (R. 62–63.)

The Metropolitan Power Company, also a Pennsylvania corporation, was organized in 1923 as a wholly owned subsidiary of the taxpayer. The taxpayer in 1923 purchased and guaranteed and sold to the public all of the bonds issued by the Metropolitan Power Company, purchased all of its stock, and loaned to that company on open account approximately $3,000,000. The bonds, in the amount of $3,250,000, were issued to the taxpayer at 90 and, after endorsement and guarantee by the taxpayer, were sold to the public at the same price. (R. 63–64.)

On February 15, 1927, the Public Service Commission of the State of Pennsylvania issued a Certificate of Public Convenience authorizing the Metropolitan Power Company to sell all of its property except public franchises to the taxpayer.[3] The actual transfer occurred on February 28, 1927, the assets and liabilities of the Metropolitan Power Company being transferred as they stood on its books and a deficit from operations being charged

[3] The Board found that the petition specifically states that the Metropolitan Power Company had no public franchises and for that reason a sale was resorted to rather than a merger. (R. 64.)

against the surplus of the taxpayer. The taxpayer surrendered the stock of the Power Company for cancellation and the latter became inactive on February 28, 1927, and was dissolved on January 8, 1928. (R. 64.) On February 28, 1927, the taxpayer assumed the liability of the Metropolitan Power Company's $3,250,000 bond issue, the payment of which had been guaranteed by it, and the intercorporate debt of the Metropolitan Power Company to the taxpayer in the sum of $3,000,000 was cancelled. (R. 64.)

The bonds in question were callable on thirty days' notice at a premium, and were called for redemption and redeemed during 1927, the taxpayer paying a premium of $243,645 on their retirement. (R. 64–65.)

At the time of the redemption of the bonds in question there remained of the discount and expense incurred on the issuance of the bonds the sum of $308,097.90 unamortized by annual deductions. That amount was claimed as a deduction in the return of the taxpayer for 1927. (R. 61, 65.)

During the year 1928 the taxpayer also retired certain obligations of the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company. (R. 66–67.) Those companies also were former subsidiaries of the taxpayer, whose obligations it had assumed when it took over their assets. (R. 68.)

The so-called mergers of all those companies with the taxpayer were effected under the Act of the General Assembly of the Commonwealth of Pennsylvania, enacted April 29, 1874, and the amendments and supplements thereto. (See Section 595, Title 15, Purdon's Pennsylvania Statutes, Appendix B, *infra*, p. 29; R. 68.)[4] They were made upon application, with the approval of the Public Service Commission of Pennsylvania, under Section 3 (c), Article III, and Sections 18 and 19, Article V, of the Public Service Company Law, and followed the issuance of a report, order and certificate of public convenience. (R. 68.) In each instance the documents relating to the transfer of assets to the taxpayer referred to the transaction as a sale of assets by the subsidiary to the parent corporation. (R. 68, 77–78.)

At the time that these obligations were redeemed there existed unamortized discount and expense with respect to them in the aggregate sum of $752,481.26. (R. 67.) The taxpayer claimed a deduction of that amount in its return for 1928. (R. 68.)

On the basis of the disallowance of the deduc-

[4] The provision in question is Act of April 29, 1874, P. L. p. 73, section 23, as amended by Act of April 17, 1876, P. L. p. 30, section 5, and Act of June 2, 1915, P. L. p. 724, section 1. An inadvertent error at R. 68 refers to the last Act as that of April 2, 1915. Although the manner of presentation in the findings might suggest otherwise, the assets of each of the companies were acquired pursuant to the same statute.

tions for unamortized discount and expense related to these bonds and the Metropolitan Power Company bonds, and because of other adjustments not here involved, the Commissioner of Internal Revenue determined deficiencies of $101,395.24 and $320,017.64 for 1927 and 1928, respectively. (R. 61.)

Upon appeal the Board of Tax Appeals sustained the Commissioner on this issue (R. 75) and determined deficiencies of $21,657.13 and $78,620.55 for 1927 and 1928, respectively. (R. 83.)[5]

The Circuit Court of Appeals reversed the Board. It held that the transactions by means of which the taxpayer absorbed the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company, had all of the essential elements of a merger; that the subsidiaries ceased to exist by operation of law; that the taxpayer, an existing corporation before the alleged merger, continued to exist thereafter and became liable for the debts of the absorbed corporation, both under the contract and by operation of law; and hence that it could deduct the unamortized bond discount and expense with respect to the bonds of the subsidiaries.

---

[5] It should be noted that the Board (R. 78–81) held that the taxpayer might deduct unamortized bond discount and expense with respect to bonds issued by another subsidiary, the Metropolitan Electric Company, for the reason that in that instance there was a strict merger or consolidation pursuant to the Act of May 3, 1909, P. L. 408, sec. 1. See Section 421, Title 15, Purdon's Pennsylvania Statutes, Appendix B, *infra*, p. 27.

The court held further that while the procedure by which the taxpayer acquired the assets and assumed the liabilities of the Metropolitan Power Company was not within the provisions of any merger statute, the essential elements of such a merger were present, it not being material that the Power Company did not automatically cease to exist upon completion of the transaction, since it was left without stockholders or property and there was a *de facto* dissolution. Accordingly, the court held that the unamortized bond discount and expense with reference to the Metropolitan Power Company bonds could be deducted.

PENNSYLVANIA WATER CASE

On August 9, 1924, the taxpayer, a Pennsylvania corporation, organized a subsidiary, the Holtwood Power Company, under the laws of Pennsylvania. It acquired all of the stock of that company except that fifty qualifying shares were placed in the names of seven directors, the taxpayer remaining the equitable owner of the latter shares. (R. 33.)

With the funds paid by the taxpayer to its subsidiary for its capital stock and the proceeds received from the sale of the bonds hereinafter mentioned, the subsidiary erected an auxiliary steam-generating plant on a site immediately adjacent to the taxpayer's hydroelectric plant.[4] (R. 33–34.)

[4] It appears that the subsidiary was organized because the energy generated at the taxpayer's plant was insufficient to serve its customers and its counsel believed that its charter did not permit it to generate electricity by steam. (R. 33.)

By an agreement between the two companies dated August 26, 1924, and effective until January 1, 1975 (R. 60–64), the subsidiary agreed to deliver electric power of the steam generating plant to the taxpayer, which in turn agreed to pay all obligations and expenses of the subsidiary and a net return of 8 per cent on the par value of all its securities at any time outstanding. It was specifically provided that the taxpayer should pay a sum to provide for amortization of debt, discount, and security issue expense and the expenses attending the issue, registration and transfer of the capital stock and bonds then or thereafter issued and outstanding, and interest on bonds or other indebtedness. (R. 34, 60–64.)

From the date of the completion of the steam plant on August 16, 1925, to December 21, 1927, all electric energy generated at the steam plant (which was not used constantly) was delivered to the taxpayer. The taxpayer's officers and employees managed the plant without compensation from the subsidiary and it was operated as a department of the taxpayer. (R. 34.)

The funds for construction were secured in part by a mortgage and deed of trust to the New York Trust Company, whereby all the subsidiary's property was transferred to the trustee to secure a bond issue which was not to exceed $25,000,000. It was provided that the bonds might be issued in series and that the first series, limited to $2,750,000, desig-

nated Series A and bearing 6 per cent interest, should be dated September 1, 1924, should mature September 1, 1954, and might be redeemed on various dates at various premiums. (R. 35.)

Series A bonds in the amount of $2,750,000 were issued by the subsidiary at a discount of $137,500, and it incurred an expense of $25,249.87 in issuing them. Deductions for amortized bond discount and expense were claimed in the consolidated returns of the taxpayer and its affiliate for the years 1924 to 1927. Because of the obligation of the taxpayer to make payments to its subsidiary for these items, which payments were deductible as business expenses, the subsidiary reported such payments as income. (R. 35–36.)

On October 4, 1927, the taxpayer surrendered its corporate power to store, transport and supply water in order to be in a position to effect a merger or consolidation with its subsidiary in accordance with the rules laid down in *York Haven Water & Power Co.* v. *Public Service Commission*, 287 Pa. 241. Thereafter, a "short form of merger" was effected pursuant to the Pennsylvania statutes previously mentioned. (See Section 595 of Title 15 of Purdon's Pennsylvania Statutes, Appendix B, *infra*, p. 29; R. 36–37.)[7]

Pursuant to the procedure described in those provisions the subsidiary, by deed dated December

[7] This transaction was treated by the Commissioner as a nontaxable exchange. (R. 37.)

21, 1927, transferred all of its franchises and property, real, personal and mixed, to the taxpayer, the sole consideration for the transfer being the delivery to the subsidiary of its capital stock held by the taxpayer and the taxpayer's assuming the indebtedness of the subsidiary. Thereupon the subsidiary ceased to exist. (R. 37.)

On March 1, 1928, the taxpayer sold to the public a $6,000,000 issue of its own bonds for the purpose of retiring some of its own bonds and the Holtwood bonds. The latter were retired on March 1, 1928, at a 7 per cent premium amounting to $192,500. (R. 37–38.)

On January 1, 1928, the unamortized discount and expense applicable to the Holtwood bonds was $145,159.52. (R. 38.)

In its income tax return for 1928 the taxpayer claimed a deduction of $904.42 for amortization of bond discount and expense for the period January 1, 1928, to February 28, 1928, and a deduction for unamortized discount and expense, as of the date of retirement, in the amount of $144,255.10. (R. 38.)

The Commissioner disallowed these deductions, made certain other adjustments which are not material here, and determined a deficiency of $86,508.25, but made claim for a deficiency of only $39,675.82 at the trial. (R. 32–33.)

Upon appeal the Board of Tax Appeals sustained the Commissioner's determination and found a deficiency of $16,575.82. (R. 45.)

The Circuit Court of Appeals reversed the Board, holding that its decision in the *Metropolitan Edison Company* case, rendered the same day, controlled this case, and hence that the deductions should be allowed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that a transfer of assets from one Pennsylvania corporation to another by an agreement pursuant to Section 595, Title 15, of Purdon's Pennsylvania Statutes effects a merger or consolidation. (Nos. 486, 487.)

2. In holding that where the successor corporation under such a contract agrees to pay the transferor's debts, it is liable for such debts by operation of law. (Nos. 486, 487.)

3. In holding that the Metropolitan Edison Company was merged or consolidated with the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company, or with any one of those companies. (No. 486.)

4. In holding that the Metropolitan Edison Company became liable for the debts of those companies by operation of law. (No. 486.)

5. In holding that when bonds issued by those corporations are redeemed by the Metropolitan Edison Company, that company should be allowed a deduction for the unamortized discount and expense. (No. 486.)

6. In holding that there was a merger or consolidation of the Pennsylvania Water & Power Company and the Holtwood Power Company. (No. 487.)

7. In holding that the Pennsylvania Water & Power Company became liable for the debts of the Holtwood Power Company by operation of law. (No. 487.)

8. In holding that when bonds issued by the Holtwood Company are redeemed by the Pennsylvania Water & Power Company, that company may deduct the unamortized bond discount and expense. (No. 487.)

9. In holding that the Metropolitan Edison Company became liable for the debts of the Metropolitan Power Company by operation of law. (No. 486.)

10. In holding that when bonds issued by the Metropolitan Power Company are redeemed by the Metropolitan Edison Company, that company is entitled to deduct unamortized bond discount and expense. (No. 486.)

REASONS FOR GRANTING THE WRITS

1. The decisions of the court below are in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *General Gas & Elec. Corp.* v. *Commissioner*, 98 F. (2d) 561. In that case the taxpayer, a Pennsylvania Corporation, acquired the assets of each of two subsidiaries, surrendering the capital stock of and assuming the

debts of each subsidiary. The transaction was carried out in accordance with Section 595, Title 15, Purdon's Pennsylvania Statutes (Appendix B, *infra*, p. 29), hereinafter referred to as the "Short-Form-Merger Statute." The question involved was whether in the year of its retirement of the subsidiary's bonds, 1928, the taxpayer could deduct the unamortized discount and expense incurred by the subsidiaries in issuing the bonds. The Circuit Court of Appeals held that the deductions were not allowable to the taxpayer, for the reason that it was not a successor corporation which through merger or consolidation had carried forward the corporate identity of the issuing corporations and assumed the liabilities of its predecessors by operation of law. Thus the case presented precisely the same question as the instant cases, and involved the same Federal statutes and regulations and the same provisions of the Pennsylvania statutes.[8] The court there held that a transfer of assets and the assumption of liabilities effected under the Short-Form-Merger Statute of Pennsylvania did not carry forward the identity of the corporation which issued the bonds and did not make the successor corporation liable for debts of the old by operation of law, and hence that the latter could not claim the deduction.

---

[8] Both the instant cases involve the year 1928, but the *Metropolitan Edison* case also involves the year 1927. There was, however, no material difference in the statutes and regulations applicable to that year.

In these cases the court below held directly to the contrary, stated (R. 97) that "the petitioner became liable for the debts of the absorbed subsidiaries both under the contract and by operation of law", and allowed the deductions to the successor corporations. Both courts considered the applicable Pennsylvania decisions and reached opposite conclusions as to the effect of the Short-Form-Merger Statute.

In construing the Pennsylvania statute the court below relied primarily upon the fact that the Pennsylvania courts had often referred to transactions effected under it as mergers, and upon the fact that for a long time it was the only method for effecting mergers as distinguished from consolidations. The statute itself uses the word "sale", and is in contradistinction to Section 423, Title 15, Purdon's Pennsylvania Statutes (Appendix B, *infra*, pp. 28–29) which expressly provides that "all debts" of each constituent corporation "shall thenceforth attach to the said new corporation."

In what the court below conceded was the only Pennsylvania case dealing with the question whether under that statute the successor corporation is liable for the debts of the selling corporation by operation of law, it was held that the seller's creditor could not sue the successor, and the court indicated, as a possible basis of liability of the successor, only the principle of fraudulent conveyance. *Merwine* v. *Mt. Pocono Light & Imp. Co.*,

304 Pa. 517. The court below declined to follow that case but cited no Pennsylvania decisions overruling it. It is believed that the court below plainly erred in declining to follow the *Mt. Pocono* case and that the Circuit Court of Appeals for the Second Circuit properly accepted that decision as controlling in its construction of the Pennsylvania statute.

Thus, there is a two-fold basis for invocation of Rule 38 of this Court. The court below not only "rendered a decision in conflict with the decision of another circuit court of appeals on the same matter" but it also "decided an important question of local law in a way probably in conflict with applicable local decisions."

2. In so far as the court below in the *Metropolitan Edison* case held that the taxpayer could deduct unamortized bond discount and expense with reference to the Metropolitan Power Company bonds, notwithstanding the fact that the transfer of assets and the assumption of liabilities was not effected pursuant to any merger or consolidation statute, its decision conflicts in principle with several decided cases which have denied the deduction of unamortized discount and expense to a successor corporation with respect to bonds issued by a predecessor, where there has not been a strict merger or consolidation. *American Gas & Elec. Co.* v. *Commissioner*, 85 F. (2d) 527 (C. C. A. 2nd); *American Gas & Electric Co.* v. *United States*, 17 F. Supp. 151 (C. Cls.); *Turner-Farber-Love Co.* v. *Helvering*, 68

. (2d) 416 (App. D. C.).* See, also, *New York, . & St. L. R. Co.* v. *Burnet,* 64 F. (2d) 152 (App. . C.).

This conflict is not resolved by the court's asser-ion that there was a *de facto* dissolution of the Metropolitan Power Company, even though it was ot formally dissolved until 1928. The only theory pon which a successor corporation has been al-owed the deduction in any case is that the life of he transferor corporation has been continued in he new corporation, so that the deduction is not eing allowed to a new or different taxpayer but o the original taxpayer whose personality is con-inued by operation of law in and through the suc-essor corporation. *American Gas & Elec. Co.* v. *Commissioner, supra; American Gas & Electric o.* v. *United States, supra; New York Cent. R. Co. . Commissioner,* 79 F. (2d) 247 (C. C. A. 2nd), ertiorari denied, 296 U. S. 653; *Western Mary-nd Ry. Co.* v. *Commissioner,* 33 F. (2d) 695 (C. C. A. 4th); *Illinois Power & Light Corp.* v. *Commissioner,* 33 B. T. A. 1189; *Connecticut Elec-ric Service Co.* v. *Commissioner,* 35 B. T. A. 444.

No other theory would support the allowance of he deduction, for one corporation is not entitled o a deduction which the law grants to another. *New Colonial Co.* v. *Helvering,* 292 U. S. 435; *Athol Mfg. Co.* v. *Commissioner,* 54 F. (2d) 230 (C. C. A. 1st). The court below itself recognized

*That decision was cited with approval by this Court in he case of *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 442.

that principle in an earlier decision involving a different kind of deduction. See *Pennsylvania Co., etc.* v. *Commissioner,* 75 F. (2d) 719 (C. C. A. 3d).

There are no express statutory provisions relative to the allowance of a deduction for amortization of bond discount, but Treasury Regulations have authorized the deduction and have provided that if the bonds are redeemed before maturity, the unamortized bond discount may be deducted at that time. See Article 68 of Regulations 74 (Appendix A, *infra,* p. 24). These regulations have been sustained by this Court (*Helvering* v. *Union Pacific Co.,* 293 U. S. 282), and a like principle has been applied to expenses incurred in issuing bonds (*Gt. W. Power Co.* v. *Commissioner,* 297 U. S. 543). The theory of the deduction is that the taxpayer issuing the bonds has a loss or an expense which should properly be spread over the life of the bonds.

This reasoning does not apply to a successor corporation which has taken over the assets of the corporation issuing the bonds and agreed to pay its debts. The successor has directly incurred no expense and, even if the value of the assets received is less than what was given for them (including the total of the predecessor's obligations which it is to pay), no loss has then been realized. When the loss is realized, deductibility would seem to depend upon provisions dealing with the recognition of gains or losses from sales. Any loss incurred does not represent bond discount or expense which may properly be amortized under the regulations.

The courts, therefore, should have held that in no case does the successor corporation have the right to the deductions for amortization of bond discount and expense during the life of the bonds or for the unamortized bond discount and expense upon the retirement of the bonds. But they have not gone so far. Instead, they have granted the allowance where there is a strict statutory merger or consolidation which preserves the identity of the transferor corporations in the successor corporation and makes the successor liable for the debts of the transferor by operation of law. We question the soundness of such decisions. In these cases, however, the court has gone further and allowed the successor the deduction, even though the transferor corporation itself had not been dissolved and there was no statutory merger or consolidation.

3. The question arising in these cases is of general importance. The decision in the *Metropolitan Edison* case clearly creates a new rule for determining when a successor corporation shall be allowed to deduct amortization of bond discount and expense with respect to bonds issued by its predecessor; and the decision, if allowed to stand, is likely to create confusion regarding the correct rule to be applied in the case of successor corporations in all States and not merely in Pennsylvania.

CONCLUSION

Because of the direct conflict of authorities, and because of the general importance of the question

involved, it is respectfully submitted that this petition for writs of certiorari should be granted.

ROBERT H. JACKSON,
Solicitor General.

NOVEMBER, 1938.

APPENDIX A

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

* * * * *

(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. * * *

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 200. When used in this title—

* * * * *

(d) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which

"paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

* * * * *

SEC. 212. (b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities

(other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

* * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise. * * *

* * * * *

Treasury Regulations 74:

ART. 68. *Sale and retirement by corporation of its bonds.*—(1) (*a*) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(2) (*a*) If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible

expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income) over the purchase price is gain or income for the taxable year.

(3) (*a*) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) over the purchase price is gain or income for the taxable year.

ART. 176. *Sale of capital stock, bonds, and capital assets.*—A corporation sustains no deductible loss from the sale of its capital stock. (See article 66.) If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. (See article

68.) Any loss sustained by a corporation upon the sale of its capital assets, computed as provided in sections 111–113 and articles 561–604, subject to the limitation provided in section 118 as to the purchase and sale of stock or securities, is deductible.

Inasmuch as Articles 545 and 563 of Regulations 69 are identical in all material respects with Articles 68 and 176 of Regulations 74 above quoted, they are not set forth separately.

APPENDIX B

Purdon's Pennsylvania Statutes, Annotated (Permanent Edition), Title 15:

SEC. 421. *Merger authorized; exceptions; exclusive franchise not extended; merger subject to act of 1907*

It shall be lawful for any corporation, now or hereafter organized under the provisions of any general or special act of Assembly authorizing the formation of any corporation or corporations, to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation into which such merger shall be made: * * *

SEC. 422. *Procedure; joint agreement; approval by stockholders; certificates; approval by governor*

Said merger or consolidation shall be made under the conditions, provisions, and restrictions, and with the powers, herein set forth; to wit,—

First. The directors of each corporation shall enter into a joint agreement, under the corporate seal of each corporation, for the merger and consolidation of said corporations; prescribing the terms and conditions thereof, the mode of carrying the

same into effect, the name of the new corporation, the number and names of the directors and other officers thereof, and who shall be the first directors and officers, and their places of residence, the number of shares of the capital stock, the amount or par value of each share, and the manner of converting the capital stock of each of said corporations into the stock of the new corporation, and how and when directors and officers shall be chosen, with such other details as they shall deem necessary to perfect the said consideration and merger; but said agreement shall not be effective unless the same shall be approved by the stockholders of said corporations, in the manner hereinafter provided.

Second. Said agreement shall be submitted to the stockholders of each of said corporations, at separate special meetings or at any annual meetings, of the time, place and object of which respective meetings due notice shall be given by publication, once a week for two consecutive weeks before said respective meetings, in at least one newspaper in the county or in each of the counties in which the principal office of said respective corporations shall be situate * * *

SEC. 423. *Effect of merger; new patent; bonus; certificate of reports and payment of taxes*

Upon the filing of said certificates and agreement, or copy of the agreement, in the office of the Secretary of the Commonwealth, and upon the issuing of new letters patent thereon by the Governor, the said merger shall be deemed to have taken place, and the

said corporations to be one corporation under the name adopted in and by said agreement possessing all the rights, privileges, and franchises theretofore vested in each of them; and all the estate and property, real and personal, and rights of action, of each of said corporations, shall be deemed and taken to be transferred to and vested in the said new corporation, without any further act or deed: Provided, That all rights of creditors and all liens upon the property of each of said corporations shall continue unimpaired, limited in lien to the property affected by such liens at the time of the creation of the same, and the respective constituent corporations may be deemed to be in existence to preserve the same; and all debts not of record, duties, and liabilities of each of said constituent corporations shall thenceforth attach to the said new corporation, and may be enforced against it to the same extent and by the same process as if said debts, duties, and liabilities had been contracted by it. * * *

SEC. 595. *Reduction of capital stock; change in value of shares; conveyance of franchise and property*

Any corporation created under the provisions of this act, and any corporation of the classes named in the second section hereof, that is now in existence by virtue of any law of this Commonwealth, may reduce its capital stock or alter and change the par value of the shares thereof, by a vote of the stockholders taken in the manner and under the regulations prescribed in the eighteenth, nineteenth, twentieth, twenty-first and twenty-second sections of this act; and it shall be lawful for any corporation in the same manner to sell, assign, dispose of and

convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid: Provided, That the returns required by said section shall not be filed in the office of the Secretary of the Commonwealth until each and every corporation, so selling, assigning, disposing, and conveying such franchises and property, shall have filed with the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth, setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed sale, assignment, disposition and conveyance; and that all taxes due the Commonwealth of Pennsylvania have been paid up to and including such date.

U. S. GOVERNMENT PRINTING OFFICE: 1939

Nos. 486 and 487

In the Supreme Court of the United States

October Term, 1938

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

METROPOLITAN EDISON COMPANY

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

PENNSYLVANIA WATER & POWER COMPANY

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE PETITIONER

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals in the *Metropolitan Edison Company* case (R. 29–44) is reported in 35 B. T. A. 1110, and that

of the Circuit Court of Appeals (R. 50–55) is reported in 98 F. (2d) 807. The opinion of the Board of Tax Appeals in the *Pennsylvania Water & Power Company* case (R. 16–25) is reported in 36 B. T. A. 467, and that of the Circuit Court of Appeals (R. 45–47) is reported in 98 F. (2d) 812.

JURISDICTION

The judgments of the Circuit Court of Appeals in the two cases were entered August 23, 1938. (*Metropolitan Edison Company case,* R. 55; *Pennsylvania Water & Power Company* case, R. 48.) A single petition for writs of certiorari in the two cases was filed November 23, 1938, and was granted January 3, 1939. (No. 486 R. 55, No. 487 R. 48.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. The taxpayer, a Pennsylvania corporation, acquired all of the assets of its wholly owned subsidiary in consideration of the delivery to the subsidiary of all of the subsidiary's capital stock and the assumption by the taxpayer of all of the subsidiary's indebtedness. This transaction was carried out in accordance with Section 595, Title 15, Purdon's Pennsylvania Statutes, *infra*. The taxpayer, the parent company, retired bonds issued at a discount by its former subsidiary. Is the taxpayer entitled to deduct from its gross income the

unamortized bond discount and expense in the year of the retirement of the bonds?

2. The facts are the same as in Question 1, except that the transaction was not carried out under any Pennsylvania statute and the subsidiary was not immediately dissolved. Is the taxpayer entitled to deduct the unamortized bond discount and expense in the year of the retirement of the bonds?[1]

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in Appendices A and B, *infra*, pp. 54–65.

STATEMENT

The facts in these cases are not in dispute and as found by the Board of Tax Appeals are as follows:

METROPOLITAN EDISON CASE

The taxpayer, the Metropolitan Edison Company, is a Pennsylvania corporation, engaged in the business of supplying electric light and power in Reading, Lebanon, and surrounding territory. Through affiliated subsidiaries it also operates a unified system of electric properties which serve other communities in Pennsylvania and northern Maryland. It filed consolidated returns in behalf of itself and its subsidiaries for the years 1927 and 1928. (R. 31.)

[1] The first question is presented in both cases. The *Metropolitan Edison Company* case presents also the second question.

The Metropolitan Power Company, also a Pennsylvania corporation, was organized in 1923 as a wholly owned subsidiary of the taxpayer to erect and operate a large electric generating plant for the manufacture of electric energy in and adjoining the Borough of Middletown, Dauphin County, Pennsylvania, and for the distribution and sale at the plant of such electric energy. All of the electricity generated at its plant was sold to the taxpayer under a contract whereby the taxpayer was to pay therefor an amount sufficient to enable the Metropolitan Power Company to earn costs of operation and other charges, including depreciation, taxes, and interest. (R. 31–32.)

The Metropolitan Power Company was organized as a separate corporation in order to finance the construction of the generating plant through a first mortgage. The taxpayer in 1923 purchased and guaranteed and sold to the public a $3,250,000 bond issue of the Metropolitan Power Company, purchased all of its stock and loaned to that company on open account approximately $3,000,000. The bonds in question were issued to the taxpayer at 90, and after endorsement and guarantee by the taxpayer were sold to the public at the same price. (R. 32.)

On February 15, 1927, the Public Service Commission of the State of Pennsylvania issued a Certificate of Public Convenience authorizing the Metropolitan Power Company to sell all of its prop-

erty except public franchises to the taxpayer.[2] The actual transfer occurred on February 28, 1927, the assets and liabilities of the Metropolitan Power Company as they stood on its books being transferred to the taxpayer's books and a deficit from operations being charged against the latter's surplus. On the same day the taxpayer surrendered the stock of the Metropolitan Power Company for cancellation and that company became inactive. It was dissolved on January 8, 1928. Also on February 28, 1927, the taxpayer assumed liability for the Metropolitan Power Company's $3,250,000 First Mortgage Gold Bonds, the payment of which it had originally guaranteed, and the intercorporate debt of the Metropolitan Power Company to the taxpayer in the approximate sum of $3,000,000 was cancelled. (R. 32.)

The bonds in question were callable on thirty days' published notice at 107½%; and pursuant to the terms of the indenture they were called for redemption and redeemed during 1927, the taxpayer paying a premium of $243,645 on their retirement. (R. 32–33.)

At the time of the redemption of the bonds in question there remained of the discount and expense incurred on the issuance of the bonds the sum of $308,097.90, unamortized by annual deductions.

[2] In that connection the Board of Tax Appeals made the following finding (R. 32): "The petition specifically states that the Power Co. had no public franchises; and for that reason a sale was resorted to rather than a merger."

R. 33.) The Commissioner refused to permit this amount to be deducted in the return of the taxpayer for 1927. (R. 30.)

During the year 1928 the taxpayer also retired at a premium certain bonds of the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company, all of which were Pennsylvania corporations. (R. 34–35.) Those companies also were former subsidiaries of the taxpayer, whose obligations it had assumed when it took over their assets pursuant to so-called mergers of those companies with the taxpayer, effected under the Act of the General Assembly of the Commonwealth of Pennsylvania, enacted April 29, 1874, and the amendments and supplements thereto. See Section 595, Title 15, Purdon's Pennsylvania Statutes, Appendix B, *infra,* p. 64.[2] In each instance the documents relating to the transfer of assets to the taxpayer referred to the transaction as a sale of assets by the subsidiary to the parent corporation. (R. 34–35, 41.)

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[2] The provision in question is the Act of April 29, 1874, P. L. p. 73, section 23, as amended by the Act of April 17, 1876, P. L. p. 30, section 5, and the Act of June 2, 1915, P. L. p. 724, section 1. An inadvertent error at R. 35 refers to the last Act as that of April 2, 1915. Although the manner of presentation in the findings might suggest otherwise, the assets of each company were acquired pursuant to the same statute.

At the time these obligations were redeemed there existed with respect to them unamortized discount and expense in the aggregate sum of $752,481.26. (R. 34.)[4] The Commissioner of Internal Revenue declined to permit the deduction of that amount in the taxpayer's return for 1928. (R. 30, 34.)

On the basis of the disallowance of the deductions for unamortized discount and expense relating to these bonds and the Metropolitan Power Company bonds, and because of other adjustments not here involved, the Commissioner determined deficiencies of $101,395.24 and $320,017.64 for 1927 and 1928, respectively. (R. 30.)

Upon appeal the Board of Tax Appeals sustained the Commissioner on these issues (R. 39–41) and determined deficiencies of $21,657.13 and $78,620.55 for 1927 and 1928, respectively. (R. 44.)[4]

The Circuit Court of Appeals reversed the Board. It held that the transactions by means of which the taxpayer acquired the assets and assumed the liabilities of the Cumberland Valley Light & Power Company, the York Haven Water & Power

[4] It should be noted that the Board (R. 41–43) held that the taxpayer might deduct unamortized bond discount and expense with respect to bonds issued by another subsidiary, the Metropolitan Electric Company, for the reason that in that instance there was a strict merger or consolidation pursuant to the Act of May 3, 1909, P. L. 408, Sec. 1. (See Section 421, Title 15, Purdon's Pennsylvania Statutes (Appendix B, *infra*, p. 61).) Messrs. Sternhagen and Murdock dissented upon that issue. (R. 41–42.)

Company, the Hanover Power Company, and the Pennsylvania Edison Company, pursuant to the short-form merger statute had all of the elements of a true merger; that the subsidiaries ceased to exist by operation of law; that the taxpayer, an existing corporation before the merger, continued to exist thereafter and became liable for the debts of the absorbed corporations, both under the contract and by operation of law; and hence that it could deduct the unamortized bond discount and expense with respect to the bonds of those subsidiaries. (R. 51–52.)

The court held further that while the procedure by which the taxpayer acquired the assets and assumed the liabilities of the Metropolitan Power Company was not within the provisions of any merger statute, the essential elements of such a merger were present, it not being material that the Power Company did not automatically cease to exist upon completion of the transaction, since it was left without stockholders or property and there was a *de facto* dissolution. Accordingly, the court held that the unamortized bond discount and expense with reference to the Metropolitan Power Company bonds could be deducted. (R. 53-55.)

PENNSYLVANIA WATER COMPANY CASE

The taxpayer, the Pennsylvania Water & Power Company, is a Pennsylvania corporation organized in 1910. (R. 17, 34.)

Prior to 1924, the taxpayer generated all electricity sold by it exclusively by water power at its hydroelectric plant located on the Susquehanna River at Holtwood, Pennsylvania. In that year it became necessary for the taxpayer to secure an auxiliary supply of electrical energy generated by steam, and since its counsel believed that its charter did not permit it to operate a steam plant, it organized, for that purpose, under the laws of Pennsylvania, a subsidiary corporation, the Holtwood Power Company. (R. 17.)

The latter company was incorporated on August 9, 1924, with an authorized capital of $1,500,000 consisting of 15,000 shares of the par value of $100 each. All of these shares were purchased by the taxpayer, but 50 of them were placed in the names of seven qualifying directors, the taxpayer retaining equitable ownership. (R. 17.)

With the amount realized from the sale of the capital stock and the proceeds of the sale of a bond issue hereinafter mentioned, the Holtwood Company erected an auxiliary steam generating plant adjacent to the taxpayer's hydroelectric plant. (R. 17–18.)

By an agreement between the two companies dated August 26, 1924, and effective until January 1, 1975 (R. 34–36), the subsidiary agreed to purchase certain land from the taxpayer (the purchase price of which was 5,000 shares of the subsidiary's stock), to erect and operate a steam plant thereon,

and to deliver, on the order of the taxpayer, electr
power up to full capacity of the plant. As com
pensation for such power, the taxpayer agreed t
pay: all expenses and costs; an allowance for de
preciation; a sum to provide for amortization o
debt discount and security issue expense and ex
penses attending the issuance, registration an
transfer of the capital stock and bonds then o
thereafter issued and outstanding; all interest o
bonds or other indebtedness; and a sum sufficien
to provide a net return of 8% annually upon th
Holtwood Company's stock. (R. 18, 34–36.) I
was stated that the intent of the agreement was t
enable the subsidiary to realize a net return of 8%
annually upon the par value of all of its securi-
ties at any time outstanding. (R. 35–36.)

From the date of the completion of the plant on
August 16, 1925, to December 21, 1927, all electric
energy generated at the steam plant was delivered
to the taxpayer. The taxpayer's officers and em-
ployees managed the plant without compensation
from the subsidiary and it was operated as a de-
partment of the taxpayer. (R. 18.)

As previously indicated, funds for construction
of the plant were secured in part by the sale of
bonds. All of the subsidiary's property was trans-
ferred to the New York Trust Company, as trustee,
to secure a bond issue which was not to exceed
$25,000,000, the bonds to be issued in series. It was
provided that "Series A", limited to $2,750,000 and

bearing 6% interest, should be dated September 1, 1924, should mature September 1, 1954, and might be redeemed on various dates, at various premiums. (R. 18–19.)

The subsidiary issued the "Series A" bonds at a discount of $137,500, and incurred an expense of $25,249.87 in issuing them. Deductions for amortized bond discount and expense were claimed in the consolidated returns of the taxpayer and its affiliate for the years 1924 to 1927, inclusive. Because of the taxpayer's obligation to make payments to the subsidiary for those items, which payments were deductible by the taxpayer as business expenses, the subsidiary reported such payments as income. (R. 19.)

On October 4, 1927, the taxpayer surrendered its corporate power to store, transport and supply water, in order to be in a position to effect a merger or consolidation with its subsidiary in accordance with the rules laid down in *Y. Hav. W. & P. Co.* v. *Pub. Serv. Com.*, 287 Pa. 241. Thereafter a "short-form of merger" was effected pursuant to the Pennsylvania statute previously mentioned. (See Section 595 of Title 15 of Purdon's Pennsylvania Statutes, Appendix B, *infra*, p. 64.) (R. 19–20.)

Pursuant to the procedure described in those provisions the subsidiary, by deed dated December 21, 1927, transferred all of its franchises and property, real, personal and mixed, to the taxpayer, the sole consideration for the transfer being the de-

livery to the subsidiary of all its capital stock held by the taxpayer, and the taxpayer's assuming the indebtedness of the subsidiary. Thereupon the subsidiary ceased to exist. This transfer was treated by the Commissioner as a non-taxable transaction giving rise to no gain or loss. (R. 20.)

On March 1, 1928, the taxpayer sold to the public a $6,000,000 issue of its own bonds for the purpose of retiring some of its own bonds and the Holtwood bonds. The latter were retired on March 1, 1928, at a 7% premium, amounting to $192,500. (R. 20.)

On January 1, 1928, the unamortized discount and expense applicable to the Holtwood Bonds was $145,159.52. (R. 21.)

In its income tax return for 1928 the taxpayer claimed a deduction of $904.42 for amortization of bond discount and expense for the period January 1, 1928, to February 28, 1928, and a deduction for unamortized discount and expense, as of the date of retirement, in the amount of $144,255.10. (R. 21.)

The Commissioner disallowed these deductions, made certain other adjustments which are not material here, and determined a deficiency of $86,508.25, but made claim for a deficiency of only $39,675.82 at the trial. (R. 17.)

Upon appeal the Board of Tax Appeals sustained the Commissioner's determination on the issue here involved and found a deficiency of $16,575.82. (R. 25.)

The Circuit Court of Appeals reversed the Board, holding that its decision in the *Metropolitan Edison Company* case, rendered the same day, controlled this case, and hence that the deduction should be allowed.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that a transfer of assets from one Pennsylvania corporation to another by an agreement pursuant to Section 595, Title 15, of Purdon's Pennsylvania Statutes effects a merger or consolidation. (Nos. 486 and 487.)

2. In holding that where the successor corporation under such a contract agrees to pay the transferor's debts, it is liable for such debts by operation of law. (Nos. 486, 487.)

3. In holding that the Metropolitan Edison Company was merged or consolidated with the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company, or with any one of those companies. (No. 486.)

4. In holding that the Metropolitan Edison Company became liable for the debts of those companies by operation of law. (No. 486.)

5. In holding that when bonds issued by those corporations are redeemed by the Metropolitan Edison Company, that company should be allowed

a deduction for the unamortized discount and expense. (No. 486.)

6. In holding that there was a merger or consolidation of the Pennsylvania Water & Power Company and the Holtwood Power Company. (No. 487.)

7. In holding that the Pennsylvania Water & Power Company became liable for the debts of the Holtwood Power Company by operation of law. (No. 487.)

8. In holding that when bonds issued by the Holtwood Company are redeemed by the Pennsylvania Water & Power Company, that company may deduct the unamortized bond discount and expense. (No. 487.)

9. In holding that the Metropolitan Edison Company became liable for the debts of the Metropolitan Power Company by operation of law. (No. 486.)

10. In holding that when bonds issued by the Metropolitan Power Company are redeemed by the Metropolitan Edison Company, that company is entitled to deduct unamortized bond discount and expense. (No. 486.)

SUMMARY OF ARGUMENT

In 1928 the taxpayers in these two cases redeemed at a premium before maturity certain bonds which had been issued at a discount by other corporations whose assets they had acquired and whose liabilities they had assumed by agreements

entered into pursuant to Section 595, Title 15, of Purdon's Pennsylvania Statutes (Appendix B, *infra*, p. 64). The court below permitted them to deduct the portion of the bond discount and expenses incurred in issuing the bonds which had not previously been amortized, upon the theory that the taxpayers had been merged with the corporations that issued the bonds, and hence were entitled to the deductions.

The decided cases establish the general rule that only the corporation which issues the bonds may deduct amortization of bond discount and expense, and that a corporation which has acquired the assets and agreed to assume the liabilities of the corporation which issued the bonds may not do so. The only recognized exception to the rule is that the deduction will be allowed where there has been a merger or consolidation under a state statute which makes the transferee liable by operation of law for the debts of the transferor and which continues the existence of the transferor within the transferee.

These cases do not come within the exception. Section 595 refers to sales of assets and not to mergers or consolidations. It does not provide that the purchaser shall become liable for the seller's debts by operation of law, and does not continue the corporate life of the seller within the purchaser. The only Pennsylvania case dealing with the question whether the purchaser becomes

liable for the debts of the seller holds that it does not and that the seller continues to have an independent existence until it is dissolved, when its existence ceases altogether. The decision of the court below holding to the contrary is in conflict with that decision and with the decision of another Circuit Court of Appeals.

The applicable statutes and regulations do not permit any further exceptions. Corporations are separate entities for tax purposes and there is no authority for holding that a successor corporation may claim deductions for bond discount and expenses which its predecessor might have claimed had it continued to exist. Under the statutes and regulations and the decided cases dealing with deductions generally, there is support for the view that even where a corporation acquires the assets of another pursuant to a true merger or consolidation, it is a different taxpayer and it may not claim deductions to which its predecessor was entitled. But in dealing with the question of deductions for amortization of bond discount and expenses, the courts have not gone so far. They have held that where there is a true merger or consolidation having the consequences hitherto described the deduction may be allowed to the successor, upon the theory that the successor has continued the life of the corporation which issued the bonds and is to be regarded as the same taxpayer. The theory cannot be applied in cases where there is a sale or even

where there is a merger or consolidation which does not have the consequence of continuing the existence of the corporation which issued the bonds.

There is no other theory upon which the courts could have justified any exception and no theory on which any additional exceptions may be sustained. There is no basis for the argument that the successor considered as an independent entity has sustained a loss. The theory upon which the deduction for amortization of bond discount and expense is based is that the discount and expense have resulted in the issuing corporation's realizing less from the sale of the bonds than it will be obliged to pay the bondholders at maturity. If it subsequently redeems the bonds at par or at a premium before maturity, it may write off the rest of the loss at that time. But if the corporation that redeems the bonds did not issue them, the two elements in the transaction which give rise to the loss are not present. The successor did not incur any expense in issuing the bonds; it did not issue them at a discount, and it did not receive the proceeds of their sale. It therefore cannot establish its right to the deduction.

In 1927 the Metropolitan Edison Company redeemed at a premium bonds issued by another corporation whose assets it had acquired and whose liabilities it had assumed. That transfer was not carried out pursuant to Section 595 or any other Pennsylvania statutes, and was consequently not a

merger or consolidation in any sense in which those terms are used. The allowance of the deduction of the unamortized bond discount and expense with respect to those bonds is clearly not warranted under the statute, the regulations, or the decided cases.

ARGUMENT

I

THERE WERE NO TRUE MERGERS IN THESE CASES, AND HENCE THEY DO NOT COME WITHIN THE ONLY RECOGNIZED EXCEPTION TO THE ESTABLISHED RULE THAT A CORPORATION MAY NOT DEDUCT AMORTIZATION OF BOND DISCOUNT AND EXPENSE WITH RESPECT TO BONDS ISSUED BY A PREDECESSOR WHOSE LIABILITIES HAVE BEEN ASSUMED BY AGREEMENT

In 1928 the Metropolitan Edison Company and the Pennsylvania Water & Power Company retired at a premium before maturity certain bonds issued by subsidiaries whose assets they took over and whose liabilities they assumed by agreements made pursuant to Section 595, Title 15, of Purdon's Penns' 'vania Statutes (Appendix B, *infra*, p. 64), which in terms refers to sales but which is sometimes called the Short-Form Merger Statute. The court below allowed them to deduct the discount and expense applicable to the bonds which had not been amortized up to the time of their retirement.

The Metropolitan Edison Company was also allowed similar deductions for 1927 with respect to

bonds issued by the Metropolitan Power Company, whose assets it acquired and whose liabilities it assumed by an agreement which was not entered into pursuant to any statute. The allowance of the deduction with respect to those bonds will be dealt with separately in Point III hereinafter, as in other respects the two cases present identical questions, arise under the same statute (Revenue Act of 1928), and involve no differences in fact that are material. For convenience the argument is based largely upon the facts in the Metropolitan Edison Company case and all references to the record will be understood as referring to the record in that case unless otherwise indicated.

The courts have hitherto consistently held that the mere fact that a corporation has taken over the assets and assumed the liabilities of another corporation does not permit it to deduct amortization of discount and expense with respect to bonds issued by a predecessor. *Turner-Farber-Love Co.* v. *Helvering,* 68 F. (2d) 416 (App. D. C.). (That case was cited with approval by the Supreme Court in *New Colonial Co.* v. *Helvering,* 292 U. S. 435); *General Gas & Elec. Corp.* v. *Commissioner,* 98 F. (2d) 561 (C. C. A. 2d), now pending before this Court, Nos. 492–493, present Term; *American Gas & Elec Co.* v. *Commissioner,* 85 F. (2d) 527 (C. C. A. 2d); *American Gas & Electric Co.* v. *United States,* 17 F. Supp. 151 (C. Cls.). The only exception which has been recognized is that when there has been a true merger or consolidation, the

life of the corporation issuing the bonds continuing in the successor and the successor becoming liable for the debts of the issuing corporation by operation of law, the successor has been allowed the deduction. *American Gas & Elec. Co.* v. *Commissioner, supra; American Gas & Electric Co.* v. *United States, supra; New York Cent. R. Co.* v. *Commissioner*, 79 F. (2d) 247 (C. C. A. 2d), certiorari denied, 296 U. S. 653; *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. (2d) 695 (C. C. A. 4th)[5]. See also *Illinois Power & Light Corp.* v. *Commissioner*, 33 B. T. A. 1189; *Connecticut Electric Co.* v. *Commissioner*, 35 B. T. A. 444. Thus the courts have denied the deduction where there was admittedly a non-taxable reorganization but not a true merger or consolidation. *American Gas & Elec. Co.* v. *Commissioner, supra; American Gas & Electric Co.* v. *United States, supra.*

The court below held that the transactions by which the Metropolitan Edison Company took over the assets and assumed the liabilities of the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Han-

[5] Although there is language in the *Western Maryland Ry. Co.* case which might be construed as defining the exception more broadly, the court which decided that case subsequently stated that its application was limited to cases where there was a strict merger or consolidation (*Brandon Corp.* v. *Commissioner*, 71 F. (2d) 762 (C. C. A. 4th)), and other courts have so interpreted the decision (*American Gas & Elec. Co.* v. *Commissioner, supra; Turner-Farber-Love Co.* v. *Helvering, supra*).

over Power Company, and the Pennsylvania Edison Company effected mergers under Section 595 of Title 15 of Purdon's Pennsylvania Statutes, *infra;* that such mergers had all of the essential elements of a true merger, in that the subsidiaries ceased to exist by operation of law and the taxpayer, an existing corporation before the alleged merger, continued to exist thereafter and became liable for the debts of the absorbed corporation, both under the contract and by operation of law; and hence that it could deduct the unamortized bond discount and expense with respect to the bonds of its subsidiaries. It applied the same reasoning in the *Pennsylvania Water & Power Company* case.[6]

On substantially identical facts the Circuit Court of Appeals for the Second Circuit held in *General Gas & Elec. Corp.* v. *Commissioner, supra,* that a transaction carried out pursuant to Section 595 did not effect a true merger or consolidation, and hence that the deduction was not allowable. Both courts conceded that that question was to be determined under the laws of Pennsylvania and both considered that the decision of the Supreme Court of Pennsylvania in the case of *Merwine* v. *Mt. Pocono Light & Imp. Co.,* 304 Pa. 517, had held that any liability of the purchasing corporation under

[6] In that case the Pennsylvania Water & Power Company acquired the assets of the Holtwood Power Company and agreed to assume its liabilities in a transaction carried out pursuant to Section 595. (R. 20.)

the Pennsylvania statute in question rested upon the principles governing fraudulent conveyances.

Section 595 of Purdon's Pennsylvania Statutes (Appendix B, *infra*, p. 64) had its origin in Section 23 of the Act of April 29, 1874, as amended by Section 5 of the Act of April 17, 1876. It relates generally to reductions in capital stock, changes in the value of shares, and conveyances of franchises and property upon a vote of the stockholders taken in the manner prescribed in other sections. In so far as material here, it provides that—

> * * * it shall be lawful for any corporation in the same manner to sell, assign, dispose of and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid: * * *

It should be noted that this statute in terms applies to sales and not to mergers or consolidations, and that it does not provide that the purchasing corporation shall assume the debts of the seller. It leaves all of the conditions of the transfer to be fixed by agreement between the parties. In those respects it is in direct contrast with Sections 421-423 of Purdon's Pennsylvania Statutes[7] (Appen-

[7] The origin of those statutes is to be found in the Act of May 3, 1909, P. L. 408.

dix B, *infra*, pp. 61–63), which relate specifically to the merger and consolidation of companies. Section 423 provides—

> That all rights of creditors and all liens upon the property of each of said corporations shall continue unimpaired, limited in lien to the property affected by such liens at the time of the creation of the same, and the respective constituent corporations may be deemed to be in existence to preserve the same; and all debts not of record, duties, and liabilities of each of said constituent corporations shall thenceforth attach to the said new corporation, and may be enforced against it to the same extent and by the same process as if said debts, duties, and liabilities had been contracted by it.

No suggestion is made that the transactions in these cases did not conform to the pattern prescribed by Section 595. The Board of Tax Appeals pointed out that in each instance the documents showing the details of the various transactions by which the Metropolitan Edison Company acquired the assets and assumed the liabilities of the subsidiaries referred to the transactions as sales. (R. 41.)

We submit that transfers effected under Section 595 constitute sales and not mergers; but in any event they do not have the characteristics of a true merger within the rules heretofore laid down by the decisions dealing with the issue here involved.

It is apparent upon the face of Section 595 that transfers made under it do not effect a merger or consolidation, but any doubt on that subject is resolved by a consideration of the decision in *Merwine* v. *Mt. Pocono Light & Imp. Co., supra.*

In that case the plaintiff sued the Mt. Pocono Light & Improvement Company to recover damages for personal injuries sustained as the result of negligent acts of that company. Subsequent to the institution of the suit the defendant, with the approval of the Public Service Commission, had sold all of its assets to the Pennsylvania Power & Light Company under the authority of the statutes here involved, but the latter company had not agreed to assume its debts. The defendant asked that the action be abated and the plaintiff filed an answer asking for a rule to show cause why the Pennsylvania Power & Light Company should not be substituted as a party defendant. The trial court denied the substitution and abated the action against the Mt. Pocono Light & Improvement Company. The appellate court held that the trial court properly refused to substitute the successor corporation as a party defendant, but that the old company continued to have an existence for the payment of the claim for damages, which was asserted before the sale was made, and that the action should not have been abated. In so holding the court was careful to point out that a corporation whose assets are sold under Section 3 of the Act of

April 29, 1874, as amended by the Act of April 17, 1876 (Section 595, Purdon's Pennsylvania Statutes, *infra*), continues in existence as an inactive corporation until its dissolution. The court said (pp. 522–523):

> Defendant corporation not having been legally dissolved, its present condition is rather that of an inactive corporation and it is not altogether dead. Before a corporation has ceased to exist in the absolute sense here contended for, it must fully and definitely close its affairs, and the fact that a corporation has "ceased to do business" does not preclude it from exercising its various rights to accomplish this purpose: *Stern, etc.*, v. *Smith & Co.*, 273 Pa. 39, 41. Even though the charter of a corporation has expired,—and certainly defendant's has not done so,—the Act of Assembly of May 21, 1881, P. L. 30, continues its corporate existence to the extent that suits already brought by creditors may be maintained and defended.

It is clear that in refusing to substitute the Pennsylvania Water & Power Company as a party, and in requiring the plaintiff to sue the old company, which had no assets, the court recognized that the purchaser of the assets was not liable for the debts of the seller by operation of law. Obviously, if it had thought otherwise, the court would have permitted the substitution of the purchaser as defendant, and would not have compelled the claimant to

sue the seller. The court did suggest, but did not decide, that because of the circumstances under which the sale was made, such as the identity of the officers of the two corporations, the purchaser might be liable for the debts of the seller, but made no suggestion that it was liable under the statute itself. The exact language of the court was as follows (pp. 524–525):

> Although we need not decide the point, it is proper to call attention to the fact that the pleadings indicate that the Pennsylvania Power & Light Company took over the property of defendant under circumstances warranting a finding, upon evidence produced to support the allegations in the pleadings, that the transaction between the two corporations was in reality a merger, or such union of interests as, in law, caused the buying corporation to assume defendant's obligations. There is much to show that the purchase was attended by an intimacy of interest tending to render the transaction, in so far as the Pennsylvania Power & Light Company's interest was concerned, a purchase *cum onere*. For instance, it is averred that, at the time of the commission of the alleged negligent acts on the part of the Mount Pocono Light & Improvement Company, it was affiliated or associated with the Pennsylvania Power & Light Company to the extent that both companies were managed, operated and controlled under the same management and system. It is admitted that the common stock

of both companies was owned by the same holding company, and, by defendant's own showing, thirteen of the same persons were officers or directors in both companies. It further appears that both companies operated from the same office. Plaintiff states that the business of the Mount Pocono Company was conducted by the agents, servants and employees of the Pennsylvania Power & Light Company; that after the sale, the power company took over and operated the business formerly conducted by defendant; and that the sale was merely a formality giving effect to a union of the companies which had in reality occurred previous to the accident upon which the suit is based. *Whatever the liability of the Pennsylvania Power & Light Company may or may not prove to be, we pass that point and note that the proper course at the present state of proceedings requires plaintiff first to proceed to judgment against defendant if she can, and, having secured judgment, to levy where defendant's assets liable for the judgment may be found.* [Italics supplied.]

It is obvious that by its reference to a purchase *cum onere* the court meant that the purchaser might be held liable upon the principle of a fraudulent conveyance, and only upon that principle. The Circuit Court of Appeals for the Second Circuit so construed the decision in *General Gas & Elec. Corp.* v. *Commissioner, supra,* and the court below apparently conceded that the *Mt. Pocono Light & Imp. Co.* case, *supra,* did stand for that principle.

The court below gave no reason for refusing to follow the decision in the *Mt. Pocono* case and cited no authority in support of its view that the successor corporation becomes liable for the debts of the predecessor under Section 595. For the most part, it relied upon the fact that transactions under Section 595 had often been referred to by the Pennsylvania courts as mergers, and for a long time there was no other merger statute, Sections 421-423, *infra* (sometimes referred to as the Long Form Merger Statutes), merely providing for consolidations.

Taxpayers' counsel argued in the court below that if a successor corporation is liable for the debts of a predecessor on any principle, it is liable by operation of law. It is clear that that is not what the courts have meant by that phrase. The fact that a corporation may be liable for the debts of its predecessor upon the principle of a fraudulent conveyance or under the trust fund doctrine, or because it has contracted to pay those debts, does not mean that it is liable by operation of law. In the first instance the remedy is an equitable remedy and in the second, if the creditor is permitted to sue the successor directly, it is only as the third party beneficiary of a contract. It is only where the statute governing consolidations or mergers requires the successor to assume the debts and permits that corporation to be sued upon them as if they were its own debts, that there is a liability by

operation of law. *American Gas & Elec. Co.* v. *Commissioner, supra; American Gas & Electric Co.* v. *United States, supra.* See also *Guaranty Trust Co.* v. *N. Y. & Q. C. Ry. Co.*, 253 N. Y. 190.

It should be noted that the decision in *Merwine* v. *Mt. Pocono Light & Imp. Co., supra,* also recognizes that a corporation which has sold its assets pursuant to Section 595 continues its independent existence until it is formally dissolved. That fact is wholly inconsistent with the view that the purchaser continues the existence of the seller within itself. The court below did not state that the law was otherwise. It stated that the seller ceased to exist altogether, but apparently thought that that was immaterial since the purchaser (the taxpayer) existed both before and after the transaction. It thus ignored completely the theory on which cases of this character have previously been decided. The corporations whose identity was required to be preserved in the successor corporation in order to justify the allowance of the deductions claimed were the sellers, not the purchaser. *American Gas & Elec. Co.* v. *Commissioner, supra; American Gas & Electric Co.* v. *United States, supra; General Gas & Elec. Corp.* v. *Commissioner, supra.*

It is true that transactions under Section 595 have been referred to in some Pennsylvania decisions as mergers. *Penna. Utilities Co.* v. *Pub. Serv. Com.*, 69 Pa. Super. Ct. 612; *Hey* v. *Springfield Water Co.*, 207 Pa. 38; *Y. Hav. W. & P. Co.* v.

Pub. Serv. Com., 287 Pa. 241. But they have been referred to in many other cases as sales. *Greensburg Borough* v. *W. Water Co.*, 240 Pa. 481; *Koehler* v. *St. Mary's Brew. Co.*, 228 Pa. 648; *Carr* v. *Rochester Tumbler Co.*, 207 Pa. 392; *Maxler* v. *Freeport Bank*, 275 Pa. 510; *Ringler* v. *Atlas Portland C. Co.*, 301 Pa. 176; *Buist's Estate*, 297 Pa. 537. It should be noted that the opinion in the *Buist's Estate* case was written by Justice Kephart, who also wrote the opinion in two cases relied upon by the court below. *Penna. Utilities Co.* v. *Pub. Serv. Com., supra; Y. Hav. W. & P. Co.* v. *Pub. Serv. Com., supra.* In *Buist's Estate, supra*, which was later in point of time, Justice Kephart said (p. 541):

> Care should be taken to distinguish consolidation from proceedings under the Act of 1876, P. L. 33, often referred to as a "short form merger" (See *York Haven W. & P. Co.* v. *Pub. Ser. Com.*, 287 Pa. 241); its operation in reality effects a sale of all the company's assets.

In any event, it is not material what name is given to transfers effected under Section 595 by the Pennsylvania decisions. *Burk-Waggoner Oil Assn.* v. *Hopkins*, 269 U. S. 110. It would not matter if Section 595 itself referred to transactions thereunder as mergers, if they were not true mergers having the characteristics which the courts have hitherto found essential for a successor corpo-

ration to take deductions for amortization of bond discounts and expense with respect to bonds issued by its predecessor. As hitherto pointed out, those essentials are that the existence of the issuing corporation be perpetuated in the successor and that the latter become liable for the debts of the former by operation of law and not by agreement. The court below cited no cases supporting the view that that is the law of Pennsylvania. The statute itself does not provide that a sale under Section 595 has that result, and the only decision in point (*Merwine v. Mt. Pocono Light & Imp. Co., supra*) is to the effect that it does not.

It is no answer to these facts to suggest, as did the court below, that under the Long Form Merger statute as well as under this statute the new corporation is a different entity and the absorbed corporation ceases to exist. The vital distinction between a merger under the Long Form Merger statute and a sale under the so-called Short Form Merger statute apparently is that under the former, while the absorbed corporation ceases to exist as an independent entity, it continues to exist within the successor corporation, whereas this is not true under the Short Form Merger statute involved in this case. It may be that the deduction would not be allowable even if there had been a merger under the Long Form Merger statute in these cases. But even if it were allowable under

the Long Form Merger statute, that fact is immaterial here.[8]

We submit, therefore, that the transactions carried out under Section 595 in these cases do not constitute true mergers or consolidations and that under principles established in the decided cases dealing with the question here involved the deductions claimed are not allowable.

II

THE RULE THAT HAS HITHERTO BEEN ESTABLISHED IN THIS TYPE OF CASE IS FUNDAMENTALLY SOUND AND NO FURTHER EXCEPTIONS SHOULD BE CREATED

In Point I of the Argument we have shown that it is the established rule that a corporation which has taken over the assets and agreed to assume the liabilities of another corporation cannot deduct amortization of bond discount and expense with respect to bonds issued by the latter corporation. *Turner-Farber-Love Co.* v. *Helvering,* 68 F. (2d)

[8] It should be noted, however, that Section 423 (Appendix B, *infra*, p. 63) does make the successor liable for the debts of the predecessor by operation of law. The Board of Tax Appeals held that the Metropolitan Edison Company could deduct amortization of bond discount and expense with reference to the bonds of the Metropolitan Electric Company, where there was a merger under Section 421, *infra*. Messrs. Sternhagen and Murdock dissented on that issue. (R. 43–44.) See also *Pennsylvania Co., Etc.*, v. *Commissioner*, 75 F. (2d) 719 (C. C. A. 3d), holding that the successor could not deduct a loss sustained by a predecessor absorbed under Section 421.

416 (App. D. C.); *American Gas & Elec. Co.* v. *Commissioner,* 85 F. (2d) 527 (C. C. A. 2d); *American Gas & Electric Co.* v. *United States,* 17 F. Supp. 151 (C. Cls.). We have also shown that the only recognized exception to that rule is that the deduction will be granted where there is a true merger or consolidation, the successor becoming liable for the debts of the issuing corporation by operation of law and essentially preserving the latter's continuity of existence. *American Gas & Elec. Co.* v. *Commissioner, supra; Western Maryland Ry. Co.* v. *Commissioner,* 33 F. (2d) 695 (C. C. A. 4th); *New York Cent. R. Co.* v. *Commissioner,* 79 F. (2d) 247 (C. C. A. 2d), certiorari denied, 296 U. S. 653; *American Gas & Electric Co.* v. *United States, supra.*

For reasons stated in Point I, this case does not come within that exception. Hence the only remaining question is whether the established rule is sound and whether the creation of additional exceptions is justified by the applicable statutes and the regulations.

The Revenue Act of 1928, like previous revenue statutes, contains no specific mention of bond discount and expense and makes no provision for their amortization. *Helvering* v. *Union Pacific Co.,* 293 U. S. 282. The statute provides merely that in computing net income corporations shall be entitled to deduct all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, all interest paid or

accrued within the taxable year on indebtedness, and all losses sustained during the taxable year and not compensated for by insurance or otherwise. See Section 23 (a), (b), and (f) of the Revenue Act of 1928 (Appendix A, *infra*, p. 54). And in substance these statutes provide that deductions shall be taken for the taxable year in which paid or accrued, or paid or incurred, dependent upon the method of accounting employed in computing net income, unless in order to clearly reflect the income, they should be taken as of a different period. See Sections 41, 42, and 43, Revenue Act of 1928, *infra*.

The Treasury Regulations, however, beginning with Article 150 of Regulations 33, promulgated under the Revenue Act of 1916, have consistently provided that where a corporation issues bonds at a discount, the net amount of the discount is deductible and should be prorated over the life of the bonds. See Article 68 of Regulations 74 (Appendix A, *infra*, p. 58), and Article 545 of Regulations 69 (Appendix A, *infra*, p. 60). Previous regulations to the same effect have been sustained by this Court, and it is no longer open to question that a corporation issuing bonds at a discount is entitled to deductions for their amortization over the life of the bonds. *Helvering* v. *Union Pacific Co.*, 293 U. S. 282; *Old Mission Co.* v. *Helvering*, 293 U. S. 289. Upon like principles this Court has held that expenses incurred in issuing bonds may be amortized over the life of the bonds and deducted ratably

each year. *Helvering* v. *Union Pacific Co., supra; Gt. W. Power Co.* v. *Commissioner,* 297 U. S. 543. The theory of the deductions, whether regarded as expenses or losses, or additions to the effective interest rate, is that the discount and expense reduce by their amount the capital realized by the taxpayer from the bond issue, and, while they come out of the pocket of the taxpayer only upon the payment of the bonds at maturity, the loss which is definite as to its date and amount may properly be amortized over the life of the bonds. In the *Union Pacific Co.* case, *supra,* this Court said (pp. 286, 287):

> Both commissions and discount, as the Government concedes, are factors in arriving at the actual amount of interest paid for the use of capital procured by a bond issue. The difference between the capital realized by the issue and par value, which is to be paid at maturity, must be added to the aggregate coupon payments in order to arrive at the total interest paid. Both discount and commissions are included in this difference. If the difference be viewed as a loss resulting from the funding operation, it is one which is realized only upon the payment of the bonds at maturity.
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> * * * * *
>
> * * * We think that the revenue acts, as they have been interpreted by this Court and the treasury regulations upon this and related subjects, require that this difference between receipts and disbursements of the

taxpayer should, in some form, enter into the computation of his taxable income. It is a loss to the taxpayer, definite as to its date and amount, and represents a part of the cost of the borrowed capital during each year of the life of the bond issue. Cf. *United States* v. *Anderson, supra*. At least where the taxpayer's books are kept upon the accrual basis, its final disbursement may be anticipated by amortization and the amortized amount deducted annually from his gross income.

Article 68 of Regulations 74 further provides that if after issuing bonds at a discount, the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. Under these regulations when a corporation retires bonds issued at a discount at par or for a premium, the courts have held that it is entitled to deduct the portion of the bond discount and expense which has not previously been deducted. *Gt. W. Power Co.* v. *Commissioner, supra; San Joaquin Light & Power Corp.* v. *McLaughlin*, 65 F. (2d) 677 (C. C. A. 9th); *Helvering* v. *California Oregon Power Co.*, 75 F. (2d) 644 (App. D. C.); *Helvering* v. *Union Public Service Co.*, 75

F. (2d) 723 (C. C. A. 8th); *Helvering* v. *Central States Electric Corp.*, 76 F. (2d) 1011 (C. C. A. 2d).

In 1928 the Metropolitan Edison Company retired at a premium bonds which had been issued at a discount by its subsidiaries, the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company, and there was then outstanding unamortized bond discount and expense amounting in the aggregate to $752,481.26. (R. 34.) That item would admittedly be deductible in the returns of the subsidiaries if they had continued in existence and redeemed the bonds, or it would have been deductible by the Metropolitan Edison Company if it had issued the bonds. But that is not the situation. The deduction is claimed by the Metropolitan Edison Company which did not issue the bonds although it did redeem them after it assumed the obligation to pay them.

The only two theories which would support the allowance of a deduction in such a situation are: (1) That the statutes and regulations permit a successor to claim deductions which its predecessor might have claimed if it had continued in existence, and (2) that the agreement to pay off the bonds at maturity caused a loss to the successor which is measured by the unamortized bond discount and expense at the time of their redemption. We submit that neither theory is sound.

This Court has repeatedly held that a taxpayer may not claim a deduction which the statute in terms grants to another. *Planters Oil Co.* v. *Hopkins*, 286 U. S. 332; *Welch* v. *Helvering*, 290 U. S. 111; *Burnet* v. *Clark*, 287 U. S. 410; *New Colonial Co.* v. *Helvering*, 292 U. S. 435. It has also recognized that the fact that one corporation has taken over the assets of another and agreed to assume its liabilities does not mean that it is to be granted the deductions which its predecessor might have had if it had continued in existence. *New Colonial Co.* v. *Helvering, supra.* Separately organized corporations are separate entities for tax purposes and except in so far as the statutes themselves provide that a successor is to be identified with its predecessor (for example, in the case of gains or losses arising from sales after a reorganization), the successor is not identified with the predecessor and may not take the deductions to which the latter would have been entitled.

The statutes and regulations here involved do not create any exception to the general rule. The regulations do not provide that a successor corporation shall be permitted to deduct amortization of bond discount and expense with respect to bonds issued by its predecessor. See Article 68 of Regulations 74 (Appendix A, *infra*, p. 58). They grant the deduction in terms only to the corporation issuing the bonds. Moreover the statutes authorizing deductions for losses, interest, and expenses, under

one or more of which amortization of bond discount and expense is deductible, refer to losses sustained and expenses and interest paid by a particular taxpayer. Hence it is not enough to say that because the subsidiaries might have claimed the deduction for amortization of bond discount and expense and might have deducted the unamortized bond discount and expense upon the retirement of the bonds, the Metropolitan Edison Company as their successor may claim the same deductions.

If there were any doubt on this question it would be removed by a consideration of the cases in which it has been held that a successor corporation taking over the assets of a corporation and assuming its liabilities by agreement, is not entitled to deductions for losses which the predecessor might have claimed if it had continued in existence.

New Colonial Co. v. *Helvering,* 292 U. S. 435, involved the question whether a successor corporation could deduct a net loss sustained by its predecessor. Both corporations had been organized under the laws of New York to engage in the same business and by agreement the new corporation took over the assets and agreed to assume the liabilities of the predecessor. No cash was involved in the transaction. The agreement included provisions for the issuance of stock by the new company to the old equal in class, par value, and number of shares to the outstanding stock of the old company, so that the old company could make an exchange, share for share, with its stockholders and thereby

retire its outstanding stock. The existence of the old company was continued something more than a year before it was dissolved, though after the transfer it transacted no business and had no assets. The Court held that the net loss sustained by the predecessor could not be deducted by the taxpayer, for the reason that it was a different taxpayer. It stated that the statutes dealing with the recognition of gain or loss from reorganizations did not touch the problem and that it was unimportant that the continuity of the enterprise was preserved or that the stockholders and creditors were substantially the same as before the transfer. The Court said in part (p. 439):

> The petitioner insists that the continuity of the business was not broken by the transfer from the old company to the new; and this may be conceded. But it should be observed that this continuity was accomplished by deliberate elimination of the old company and substitution of the new one. Besides, the matter of importance here, as will be shown presently, is not continuity of business alone but of ownership and tax liability as well. Had the transfer from one company to the other been effected by an unconditional sale for cash there would have been continuity of business, but not of ownership or tax liability.

Other cases to the same effect are: *Athol Mfg. Co.* v. *Commissioner*, 54 F. (2d) 230 (C. C. A. 1st); *Brandon Corp.* v. *Commissioner*, 71 F. (2d) 762

(C. C. A. 4th); *Cem Securities Corp.* v. *Commissioner*, 72 F. (2d) 295 (C. C. A. 4th), certiorari denied, 293 U. S. 613; *May Oil Burner Corp.* v. *Commissioner*, 71 F. (2d) 644 (C. C. A. 4th); *Shreveport Producing & Refining Co.* v. *Commissioner*, 71 F. (2d) 972 (C. C. A. 5th), certiorari denied, 293 U. S. 616. These decisions are in accord with the general theory that the separate entity of a corporation cannot be disregarded to give another corporation or individual the benefit of a deduction. *Dalton* v. *Bowers*, 287 U. S. 404; *Burnet* v. *Clark*, 287 U. S. 410; *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415; *Planters Oil Co.* v. *Hopkins*, 286 U. S. 332.

It may be argued that the *New Colonial Co.* case, *supra*, and other cases cited in connection therewith are distinguishable because they dealt with net losses, the deduction of which is specifically limited to the taxpayer sustaining the loss. But the *Athol Mfg. Co.* case involved not only the question whether the successor could deduct net losses sustained by the predecessor, but also the question whether the successor could deduct amounts paid to satisfy the obligations of its predecessor which it had agreed to pay, and the court held that the latter amounts could not be deducted.[9] The only

[9] In *Shreveport Producing & Refining Co.* v. *Commissioner*, *supra*, it was held that the successor corporation could not deduct a loss on stock taken over from its predecessor because the stock was worthless when acquired and no loss fell upon the successor.

distinction between that case and these is that here the taxpayers are not seeking to deduct the total amount paid to retire the obligations assumed, but are claiming that by virtue of their assumption of those obligations they are entitled to deduct unamortized bond discount and expense which their predecessors might have claimed. In neither case is the deduction allowable.

Upon the general reasoning of this Court in the *New Colonial Co.* case, *supra*, it is possible to argue that even in the case of a true merger or consolidation having the incidents which have been described, the successor is nevertheless to be regarded as a separate taxable entity and is not entitled to deductions for losses or for amortization of bond discount or expense which would have been allowable to its predecessor if it had continued in business, although the Court did point out that there the transaction was voluntary and contractual and not by operation of law. In the *Athol Mfg. Co.* case, *supra*, and in most of the cases cited above in connection therewith, it was not intimated that there would be a difference if there were a true merger or consolidation. But see *Brandon Corp.* v. *Commissioner, supra*, where three corporations were consolidated under a South Carolina statute which did not preserve the identity of the absorbed corporations, and the court suggested that a different question might have arisen if there had been a merger such as the one involved in *Western Maryland Ry. Co.* v. *Commissioner, supra.*

Notwithstanding that *dictum* we believe the courts would have been justified in holding that in no case is a successor corporation entitled to the deduction. But they have not gone that far. They have allowed amortization of bond discount and expense with respect to bonds issued by a predecessor where there was a strict merger or consolidation, upon the theory that in such cases the identity of the corporation was essentially preserved so that in substance it was the same corporation that issued the bonds. Thus, in *American Gas & Elec. Co.* v. *Commissioner, supra,* the court, in holding that the Appalachian Electric Power Company might deduct amortization of bond discount with respect to bonds issued by the Appalachian Power Company, said in part (85 F. (2d) at 530–531):

> But the situation of the bonds of the Appalachian Power Company is different. Under the decisions of *New York Central R. Co.* v. *Commissioner,* 79 F. (2d) 247 (C. C. A. 2), and *Western Maryland R. Co.* v. *Commissioner,* 33 F. (2d) 695 (C. C. A. 4), deductions should be allowed in the case of those bonds if there was a merger of Appalachian Power Company in the Appalachian Electric Power Company which essentially preserved the identity of the transferor. In *Langhorne* v. *Richmond Ry. Co.* (1895), 91 Va. 369, at pages 374, 375, 22 S. E. 159, 161, where there had been a consolidation, the court said:

"The corporation which is created by such consolidation, or the surviving corporation, where another or others are merged into it or consolidated with it, is ordinarily deemed the same as each of the corporations which formed it for the purpose of answering for the liabilities of the old corporation, and may be sued under its new name or under the name of the surviving company for their debts as if no change had been made in the name or in the organization of the original corporation. * * *

"Since, by authority of law and the act of the parties, the consolidated corporations are moulded into one with none of their rights impaired, and none of their responsibilities lessened, there is no good reason why the same proceedings may not be had against the new corporation as might have been had against the old to compel payment of liabilities."

The decisions of the Virginia Court of Appeals in *American Ry. Exp. Co.* v. *Downing* (1922) 132 Va. 139, 111 S. E. 265 and in *American Ry. Exp. Co.* v. *Fleishman, Morris & Co., Inc.* (1928) 149 Va. 200, 141 S. E. 253, as well as in the *Langhorne* decision, *supra*, seem to show that, where there is a merger or consolidation under the Virginia law, the transferee corporation succeeds by operation of law to all the rights and liabilities of the former company and carries forward its identity. The allowance of the deductions for the bonds of the Appalachian Power

Company is governed, then, by our decision in *New York Central R. Co.* v. *Commissioner, supra.*

To the same effect are the decisions in *Western Maryland Ry. Co.* v. *Commissioner, supra,* and *New York Cent. R. Co.* v. *Commissioner, supra.*

We submit, therefore, that unless there is a statutory merger or consolidation which has the consequences attributed to the consolidation referred to in the above-quoted excerpt from the opinion in *American Gas & Elec. Co.* v. *Commissioner,* there is no basis for the argument that the successor corporation is the same taxpayer as the absorbed corporation which issued the bonds and is therefore to be allowed the deductions for amortization of bond discount and expense that the issuing corporation might have claimed. Where the merger or consolidation does not have those characteristics, the two corporations are separate entities and must be so regarded for tax purposes. *A fortiori,* a successor corporation is not to be regarded as the same taxpayer as its predecessor merely because it has purchased the latter's assets and agreed to pay its debts (*Turner-Farber-Love Co.* v. *Helvering, supra*), or because there has been a reorganization and both operate the same business or have the same stockholders (*New Colonial Co.* v. *Helvering, supra; American Gas & Elec. Co.* v. *Commissioner, supra*).

We submit, therefore, that there is no basis for the argument that the taxpayers in these cases should be allowed the deductions claimed for the reason that their subsidiaries might have claimed them if they had continued in existence. They are separate entities from their former subsidiaries and are to be treated separately for tax purposes.

Most of the courts which have permitted a corporation resulting from a true merger or consolidation to deduct amortization of bond discount and expense with respect to bonds of an absorbed corporation have done so upon the theory that the identity of the issuing corporation was preserved, and not upon the theory that the successor considered as a separate corporation sustained a loss of its own. *American Gas & Electric Co.* v. *United States, supra; American Gas & Elec. Co.* v. *Commissioner, supra; Western Maryland Ry. Co.* v. *Commissioner, supra.* It is true that in *New York Cent. R. Co.* v. *Commissioner, supra* (p. 249), the court suggested that no loss was sustained by issuing the bonds at a discount, and that the loss would be sustained by the consolidated corporation when the bonds matured and were paid. But the court that decided that case repudiated that suggestion in *American Gas & Elec. Co.* v. *Commissioner, supra,* holding that, notwithstanding the transfer of assets and the assumption of liabilities in a reorganization, the loss was still that of the issuing corporation.

We submit that the latter conclusion is the only sound one. The theory upon which the deduction for amortization of bond discount and expense is based, is that the discount and expense have resulted in the issuing corporation's realizing less from the sale of the bonds than it will be obliged to pay the bondholders at maturity. If it redeems the bonds at par or at a premium before maturity, it may write off the rest of the loss at that time. But if the corporation that redeems the bonds did not issue them, there are not present the two elements in the transaction which give rise to the loss. To say that it has sustained a loss because it has agreed to pay them off at maturity is like saying that one realizes a loss from a purchase without a subsequent sale, or from a short sale without a subsequent purchase. Whether or not a loss has been sustained upon the redemption of the bonds depends upon the events which occurred when the bonds were issued, but the successor corporation has no connection with those events. It did not incur any expense in issuing the bonds, it did not issue them at a discount, and it did not receive the proceeds of their sale. It, therefore, cannot establish its right to the deduction.[10]

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[10] Attention is called to the fact that the Board of Tax Appeals allowed the Metropolitan Edison Company to deduct the premium paid upon the bonds at their maturity, upon the ground that that was an expense incurred for its own benefit. (R. 37–39.) The same reasoning does not apply to the unamortized bond discount and expense.

In a case where the transfer is effected by a sale, the obligation to pay off the bonds at maturity is merely a part of the price paid by the successor for the assets taken over. *United States* v. *Hendler*, 303 U. S. 564. Even if the value of the assets received is less than what was given for them (including the total of the predecessor's obligations which it is to pay), no loss has then been realized. When the loss is realized, its amount and deductibility will depend upon and be measured by statutes dealing with the recognition and computation of gains from sales. If, however, the transfer is effected pursuant to an exchange, a loss from the exchange may have been realized at the time of the transfer, but its recognition depends upon provisions relating to gain or loss from exchanges. In neither case does the successor sustain a loss measured by the unamortized discount and expense.

We submit, therefore, that the established rule that no corporation other than the one issuing the bonds may deduct amortization of bond discount and expense is sound and that no additional exceptions are warranted by the applicable statutes and regulations.

III

THE AGREEMENT BY WHICH THE METROPOLITAN EDISON COMPANY PURCHASED THE ASSETS OF THE METROPOLITAN POWER COMPANY AND ASSUMED ITS OBLIGATIONS WAS NOT MADE PURSUANT TO ANY PENNSYLVANIA STATUTE, THERE WAS NO MERGER OR CONSOLIDATION OF ANY CHARACTER, AND THE FORMER COMPANY MAY NOT DEDUCT UNAMORTIZED BOND DISCOUNT AND EXPENSE WITH RESPECT TO THE LATTER'S BONDS UPON THEIR REDEMPTION

The court below held that in its return for 1927 the Metropolitan Edison Company (the taxpayer) was entitled to deduct unamortized discount and expense with respect to certain bonds of the Metropolitan Power Company which it retired that year at a premium. The circumstances relating to the redemption of those bonds in general resemble those relative to the redemption in 1928 of bonds issued by other corporations whose assets the taxpayer acquired, except for the fact that the agreement by which the taxpayer acquired the assets and assumed the liabilities of the Metropolitan Power Company was not entered into pursuant to any Pennsylvania statute. In view of that fact, the question as to whether the deduction should be allowed with respect to those bonds does not depend in any way upon the construction of Section 595, Title 15, of Purdon's Pennsylvania Statutes (Appendix B, *infra*, p. 64).

The Board's findings disclose that in February, 1927, the Public Service Commission of the State

of Pennsylvania issued a Certificate of Public Convenience authorizing the Metropolitan Power Company to sell all of its assets except public franchises (of which there were none) to the taxpayer, which owned all of its stock and had previously guaranteed a $3,250,000 issue of its bonds. (R. 31–32.) All assets and liabilities were transferred as they stood upon the books of the one company to the books of the other, and a deficit in operations was charged against the surplus of the taxpayer. (R. 32.) The taxpayer surrendered its capital stock in the Metropolitan Power Company for cancellation, and the latter became inactive about February 28, 1927, although it was not dissolved until January 8, 1928. (R. 32.)

Among other liabilities, the taxpayer assumed liability for the payment of the $3,250,000 bond issue previously mentioned. It redeemed those bonds at a premium during the latter part of 1927, at which time there were unamortized discount and expense amounting to $308,097.90. (R. 32–33.)

It was admitted before the Board (R. 39–40) and in the court below (R. 54) that this transfer of assets did not take place pursuant to any Pennsylvania statute. Notwithstanding that fact, the court below held that there was a merger, and that the taxpayer was entitled to the deduction claimed. It stated that there was a *de facto* dissolution of the subsidiary and that in other respects the transaction had the same consequences as a transfer made under Section 595.

We have shown in Point I of the Argument that a transfer of assets under Section 595 constitutes a sale, rather than a merger, and that even if it should be called a merger for some purposes, it is not a true merger which preserves the identity of the transferor within the transferee and makes the transferee liable for the debts of the transferor by operation of law. If our conclusions as to the proper construction of Section 595 are correct, it follows that the court below erred in assuming that because the transactions involving the Metropolitan Edison Company and the Metropolitan Power Company resembled transactions carried out pursuant to Section 595, there was a merger of those two companies. But even if our conclusions concerning Section 595 were erroneous, it would not follow that there was a merger.

It is well settled that there can be no merger by mere agreement and contract between two corporations. In addition there must be a positive authorization by the statutes of the particular State. *Clearwater* v. *Meredith,* 1 Wall. 25; *Pearce* v. *Madison & Indianapolis R. R. Co. and Peru & Indianapolis R. R. Co.,* 21 How. 441; *First State Bank of Mangum* v. *Lock,* 113 Okla. 30, 33; *North American Union* v. *Johnson,* 142 Ark. 378; *Greenville Compress* v. *Planters' Press,* 70 Miss. 669; *Traction Co.* v. *Offutt,* 17 App. D. C. 292; 15 Fletcher, Cyclopedia Corporations (Perm. Ed.), c. 61, Sec. 7045, pp. 22–24. That is the law of Pennsylvania. *Lauman* v. *The Lebanon Valley Rail-*

road Co., 30 Pa. 42. In the latter case, with reference to the proposed consolidations of two corporations, Mr. Chief Justice Lowrie said (p. 44):

> No one will deny that, without the authority of the legislature, neither of these companies has power to enter into such a contract; for, as corporations, their powers are strictly limited to the province marked out for them in their charters.

We submit, therefore, that there was no merger or consolidation of the taxpayer (the Metropolitan Edison Company) and the Metropolitan Power Company, in whatever sense that term may be used. Much less was there a merger in the sense that the identity of the latter company was continued within the taxpayer, or in the sense that the former became liable for the debts of the latter by operation of law. While the court below stated that there was an assumption of debts by operation of law, it cited no cases in support of that view, and we know of none. Cf. *Merwine* v. *Mt. Pocono Light & Imp. Co., supra.* The court did not state that the existence of the Metropolitan Power Company was continued in the taxpayer. Moreover, it conceded that the Metropolitan Power Company was not dissolved until 1928, so that it is clear that its existence could not have been merged into that of the Metropolitan Edison Company during 1927. The *de facto* dissolution to which the court referred could not accomplish such a result.

We submit, therefore, that upon the principles set forth in Points I and II, *supra*, there was no authority under the statutes or the regulations for permitting the taxpayer to deduct the unamortized discount and expense with respect to bonds issued by the Metropolitan Power Company. The statute and regulations applicable to the year 1927 are no different from those applicable to the year 1928 which have been discussed hitherto. See Sections 200 (d), 212 (b), 232, and 234 (a), (1), (2), and (4) of the Revenue Act of 1926 (Appendix A, *infra*, pp. 56–57), and Articles 545 and 563 of Regulations 69 (Appendix A, *infra*, p. 60).

Under those statutes and regulations the taxpayer is clearly not entitled to the deductions for amortization of bond discount and expense with respect to bonds issued by another corporation whose obligations it agreed to pay.

CONCLUSION

The decisions of the court below should be reversed.

Respectfully submitted.

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APPENDIX A

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

* * * * *

(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (For use of inventories, see section 22 (c).)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period.

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

SEC. 48. DEFINITIONS.
When used in this title—

* * * * *

(c) *Paid, incurred, accrued.*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 200. WHEN USED IN THIS TITLE—

* * * * *

(d) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

* * * * *

SEC. 212. (b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 232. In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226. In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the computation shall also be made in the manner provided in section 217.

* * * * *

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

* * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise. * * *

* * * * *

Treasury Regulations 74:

ART. 68. *Sale and retirement by corporation of its bonds.*—(1) (*a*) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(2) (*a*) If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income) over the pur-

chase price is gain or income for the taxable year.

(3) (*a*) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess of the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) over the purchase price is gain or income for the taxable year.

ART. 176. *Sale of capital stock, bonds, and capital assets.*—A corporation sustains no deductible loss from the sale of its capital stock. (See article 66.) If it sells its bonds at a discount, the amount of such discount is treated in the same way as interest paid, and if it retires its bonds at a price in excess of the issuing price, such excess may usually be deducted as expense. (See article 68.) Any loss sustained by a corporation upon the sale of its capital assets, computed as provided in sections 111–113 and articles 561–604, subject to the limitation provided in section 118 as to the purchase and sale of stock or securities, is deductible.

Treasury Reguations 69:

[Inasmuch as Articles 545 and 563 of these Regulations are identical in all material respects with Articles 68 and 176 of Regulations 74 above quoted, they are not set forth separately.]

APPENDIX B

Purdon's Pennsylvania Statutes, Annotated (Permanent Edition), Title 15:

SEC. 421. *Merger authorized; exceptions; exclusive franchise not extended; merger subject to act of 1907.*

It shall be lawful for any corporation, now or hereafter organized under the provisions of any general or special act of Assembly authorizing the formation of any corporation or corporations, to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation in which such merger shall be made:

* * *

SEC. 422. *Procedure; joint agreement; approval by stockholders; certificates; approval by governor.*

Said merger or consolidation shall be made under the conditions, provisions, and restrictions, and with the powers, herein set forth; to wit,—

First. The directors of each corporation shall enter into a joint agreement, under the corporate seal of each corporation, for the merger and consolidation of said corporations; prescribing the terms and conditions thereof, the mode of carrying the same into

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effect, the name of the new corporation, the number and names of the directors and other officers thereof, and who shall be the first directors and officers, and their places of residence, the number of shares of the capital stock, the amount or par value of each share, and the manner of converting the capital stock of each of said corporations into the stock of the new corporation, and how and when directors and officers shall be chosen, with such other details as they shall deem necessary to perfect the said consideration and merger; but said agreement shall not be effective unless the same shall be approved by the stockholders of said corporations in the manner hereinafter provided.

Second. Said agreement shall be submitted to the stockholders of each of said corporations, at separate special meetings or at any annual meetings, of the time, place and object of which respective meetings due notice shall be given by publication, once a week for two consecutive weeks before said respective meetings, in at least one newspaper in the county or in each of the counties in which the principal office of said respective corporations shall be situate,—excepting in the case of the merger or consolidation of corporations which, upon their original incorporation, are required by the Constitution to publish notice of intention to incorporate for a longer period than two weeks, in which case notice by publication shall be as required by the Constitution,—and at said meetings the said agreement of the directors shall be considered, and a vote of the stockholders in person or by proxy shall be taken, by ballot, for the adoption or rejection of the same, each share of stock entitling the holder thereof to one vote; and if a majority in

amount of the entire capital stock of each of said corporations shall vote in favor of said agreement, merger and consolidation, then that fact shall be certified by the secretary of each corporation, under the corporate seal thereof, and said certificates, together with the said agreement or a copy thereof, shall be filed in the office of the Secretary of the Commonwealth, who shall forthwith present the same to the Governor for his approval and when approved by the Governor the said agreement shall be deemed and taken to be the act of consolidation of said corporation.

SEC. 423. *Effect of merger; new patent; bonus; certificate of reports and payment of taxes.*

Upon the filing of said certificates and agreement, or copy of the agreement, in the office of the Secretary of the Commonwealth, and upon the issuing of new letters patent thereon by the Governor, the said merger shall be deemed to have taken place, and the said corporations to be one corporation under the name adopted in and by said agreement possessing all the rights, privileges, and franchises theretofore vested in each of them; and all the estate and property, real and personal, and rights of action, of each of said corporations, shall be deemed and taken to be transferred to and vested in the said new corporation, without any further act or deed: *Provided,* That all rights of creditors and all liens upon the property of each of said corporations shall continue unimpaired, limited in lien to the property affected by such liens at the time of the creation of the same, and the respective constituent corporations may be deemed to be in existence to preserve the same; and all

debts not of record, duties, and liabilities of each of said constituent corporations shall thenceforth attach to the said new corporation, and may be enforced against it to the same extent and by the same process as if said debts, duties, and liabilities had been contracted by it. But such merger and consolidation shall not be complete, and no such consolidated corporation shall do any business of any kind, until it shall have first obtained from the Governor of the Commonwealth new letters patent, and shall have paid to the State Treasurer a bonus, as prescribed by law, upon all its capital stock in excess of the amount of capital stock of the several corporations so consolidating, upon which the bonus required by law has been theretofore paid: *And provided further*, That new letters patent of such consolidated corporation shall not be issued by the Governor of the Commonwealth, until each corporation entering into and forming the consolidated corporation shall have filed with the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth, setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed merger, and that all taxes due the Commonwealth of Pennsylvania have been paid, up to and including said date.

SEC. 595. *Reduction of capital stock; change in value of shares; conveyance of franchise and property.*

Any corporation created under the provisions of this act, and any corporation of the classes named in the second section hereof, that is now in existence by virtue of any law of this Commonwealth, may reduce its capi-

tal stock or alter and change the par value of the shares thereof, by a vote of the stockholders taken in the manner and under the regulations prescribed in the eighteenth, nineteenth, twentieth, twenty-first and twenty-second sections of this act; and it shall be lawful for any corporation in the same manner to sell, assign, dispose of and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid: Provided, That the returns required by said section shall not be filed in the office of the Secretary of the Commonwealth until each and every corporation, so selling, assigning, disposing, and conveying such franchises and property, shall have filed with the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth, setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed sale, assignment, disposition and conveyance; and that all taxes due the Commonwealth of Pennsylvania have been paid up to and including such date: * * *

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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1938.

No. 486.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

METROPOLITAN EDISON COMPANY, Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

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C. M. TRAMMELL,
Of Counsel.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1938. No. 486.

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner,

v.

Metropolitan Edison Company,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR THE RESPONDENT.

OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals in the *Metropolitan Edison Company* case (R. 29-44), is reported in 35 B. T. A. 1110, and that of the Circuit Court of Appeals (R. 50-55) is reported in 93 F. (2d) 807.

JURISDICTION.

The judgment of the Circuit Court of Appeals was entered August 23, 1938 (*Metropolitan Edison Company case,* R. 55). At the same time the Circuit Court of Appeals entered judgment in the case of the *Pennsylvania Water and Power Company* v. *Commissioner,* 98 F. (2d) 812. A single petition for writs of certiorari in the two cases was filed November 23, 1938, and was granted January 3, 1939. (*Metropolitan Edison Company case* No. 486, R. 55, *Pennsylvania Water and Power Company case* No. 487, R. 48.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED.

1. The taxpayer, a Pennsylvania corporation, acquired all of the assets of its wholly owned subsidiary in consideration of the delivery to the subsidiary of all of the subsidiary's capital stock and the assumption by the taxpayer of all of the subsidiary's indebtedness. This transaction was carried out in accordance with Sec. 23 of the Act of 1874, as amended, Section 595, Title 15, Purdon's Pennsylvania Statutes, *infra.* The taxpayer, the parent company, retired bonds issued at a discount by its former subsidiary. Is the taxpayer entitled to deduct from its gross income the unamortized bond discount and expense in the year of the retirement of the bonds?

2. The facts are the same as in Question 1, except that the transaction was not carried out under any Pennsylvania statute and the subsidiary was not immediately dissolved. Is the taxpayer entitled to deduct the unamortized bond discount and expense in the year of the retirement of the bonds?

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved will be found in Appendices A and B, *infra,* pp. 69, 73.

STATEMENT OF THE CASE.

This brief is being filed only on behalf of the Metropolitan Edison Company, Respondent in case No. 486, and the facts pertaining thereto are as set forth in the Petitioner's Brief, pp. 3-8.

SUMMARY OF ARGUMENT.

The general rule is that a corporation which issues bonds at a discount may deduct amortization of the bond discount and expense. It is also well established that where there has been a merger or consolidation which makes the transferee liable by operation of law for the debts of the transferor and which continues the existence of the transferor within the transferee the merged company may deduct unamortized bond discount and expense remaining on bonds issued by

the predecessor, proportionately in each year and any balance remaining in the year in which the bonds are retired prior to maturity may be deducted as a loss.

In 1928 the Metropolitan Edison Company assumed, before maturity, certain bonds which had been issued at a discount by other corporations whose assets it had acquired and whose liabilities it had assumed pursuant to Section 23 of the Pennsylvania Act of 1874, as amended, Section 595, Title 15, of Purdon's Pennsylvania Statutes (Appendix B, *infra*, p. 73).

The transactions in this case carried out in accordance with the provisions of the Act of 1874 as amended, were, under Pennsylvania law, strict mergers since the predecessor corporations ceased to exist and the successor corporation became liable for their debts and obligations by operation of law. The court below found this to be the law of Pennsylvania and permitted the Metropolitan Edison Company to deduct the unamortized portion of the bond discount and expense remaining at the time that the bonds of the predecessor corporations were redeemed prior to maturity. The decision of the court below in so holding was correct, and the decision of the Circuit Court of Appeals for the Second Circuit in the case of *General Gas and Elec. Corp.* v. *Commissioner of Internal Revenue,* 98 F. (2d) 561 (now pending before the Court, Nos. 492-493, present term), in holding to the contrary, was erroneous.

In 1927 the Metropolitan Edison Company likewise redeemed, prior to maturity, bonds issued by

another subsidiary whose assets it had acquired. Even though that transfer was not carried out pursuant to the provisions of the Act of 1874, as amended, there was, nevertheless, under Pennsylvania law a *de facto* merger warranting the allowance of the deduction of the unamortized bond discount and expense with respect to those bonds.

Regardless of whether or not the transactions in this case constituted strict or *de facto* mergers, the taxpayer is, nevertheless, entitled to the deductions claimed since it was the taxpayer which actually sustained the loss in redeeming the bonds prior to maturity. Such loss was not compensated for either directly or indirectly since the taxpayer, in taking over the subsidiary companies, gave nothing in exchange for the assets acquired, by way of consideration or otherwise, which reflected or made allowance for the prospective loss which the taxpayer would sustain in redeeming the bonds prior to maturity. Furthermore, this is not a case in which one corporation is attempting to carry over or avail itself of a loss actually sustained by a predecessor corporation. No loss on account of unamortized bond discount and expense was sustained at all until the taxpayer redeemed the bonds of the predecessor companies whose assets and liabilities it had carried over and assumed.

The attempt of the petitioner to limit the allowance of such deductions to cases where there has been a statutory merger ignores the legislative intent that in computing its net taxable income a corporation

may deduct a loss which it has sustained and for which it has not been compensated. By taking over the assets and assuming the liabilities of the predecessor corporations in the manner involved in this case, the taxpayer acquired assets which represented the proceeds of the sale of the bonds and against which there remained unamortized bond discount and expense for which no compensating adjustment was or could have been made to the taxpayer, as the transactions were essentially mergers and not sales. Since the taxpayer and the taxpayer alone, actually sustained a loss when the bonds were redeemed prior to maturity, it is entitled to take the deductions claimed.

ARGUMENT.

I.

The Transactions by Which the Metropolitan Edison Company Took Over the Assets and Assumed the Liabilities of Certain Subsidiaries Pursuant to Section 595, Title 15 of Purdon's Pennsylvania Statutes Were True Mergers and Hence Come Within the Established Rule That a Corporation Succeeding Through Merger to the Assets and Liabilities of Another May Deduct Amortization of Bond Discount and Expense With Respect to Bonds Issued by a Predecessor.

In 1928, the Metropolitan Edison Company retired at a premium before maturity, certain bonds issued

y certain of its subsidiaries whose assets it took over nd whose liabilities it assumed pursuant to the provisions of Section 23 of the Act of 1874, as amended, Section 595, Title 15 of Purdon's Pennsylvania Statutes (Appendix B, *infra*, p. 73). The subsidiary companies involved were the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company and the Pennsylvania Edison Company. The total amount of the unamortized bond discount and expense on the bonds issued by these companies amounted to $752,481.26 (R. 34). The court below allowed the Metropolitan Edison Company to deduct the discount and expense applicable to the bonds which had not been amortized up to the time of their retirement.

The Petitioner, on pages 19 and 20 of his brief, admits that when there has been a true merger or consolidation so that the life of the corporation issuing the bonds continues in the successor and the successor becomes liable for the debts of the issuing corporation by operation of law, the successor is allowed to deduct amortization of discount and expense with respect to bonds issued by the predecessor, and unamortized discount and expense on any such bonds which are retired prior to maturity, citing the *American Gas & Elec. Co.* v. *Commissioner*, 85 F. (2d) 527 (C. C. A. 2d); *American Gas & Electric Co.* v. *United States*, 17 F. Supp. 151 (C. Cls.); *New York Cent. R. Co.* v. *Commissioner*, 79 F. (2d) 247 (C. C. A. 2d), certiorari denied, 296 U. S. 653; *Western Maryland Ry. Co.* v. *Commissioner*, 33 F.

(2d) 695 (C. C. A. 4th). See also *Illinois Power & Light Corp.* v. *Commissioner,* 33 B. T. A. 1189; *Connecticut Electric Co.* v. *Commissioner,* 35 B. T. A. 444.

The Respondent here contends that it should be allowed the deduction under the above stated rule for the reason that the transactions by which the Metropolitan Edison Company took over the assets and assumed the liabilities of its subsidiaries pursuant to the provisions of Section 23 of the Act of 1874, as amended, Section 595, Title 15, of Purdon's Pennsylvania Statutes, *infra,* had all of the essential elements of a true merger in that, under Pennsylvania law, the subsidiaries ceased to exist by operation of law and the taxpayer continued to exist thereafter and became liable for the debts of the absorbed corporations both under contract and by operation of law. In this contention the Respondent was sustained by the court below which likewise applied the same reasoning in the case of the *Pennsylvania Water & Power Company.*

As has been pointed out by the Petitioner in his brief, on substantially the identical facts the Circuit Court of Appeals for the Second Circuit held in the case of *General Gas and Electric Corp.* v. *Commissioner,* 98 F. (2d) 561 (C. C. A. 2nd), that the transactions carried out pursuant to Section 595 did not effect a true merger and hence that the deductions were not allowable.

Both the Circuit Court of Appeals for the Third Circuit and the Circuit Court of Appeals for the

Second Circuit stated that the question was to be determined under the laws of Pennsylvania.

When the Metropolitan Edison Company absorbed its subsidiary companies, two forms of transactions were authorized under the laws of Pennsylvania by which the assets and franchises of one corporation might be taken over by another. One course of procedure, sometimes referred to in the Pennsylvania cases as the "long form merger," was provided for by the Act of May 3, 1909, Title 15, Purdon's Pennsylvania Statutes, Section 421, *et seq.* (Appendix B, *infra,* p. 74). The other form of procedure, sometimes referred to in the Pennsylvania cases as the "short form merger," was provided for by Section 23 of the Act of April 29, 1874, as amended, Title 15, Purdon's Pennsylvania Statutes, Section 595 (Appendix B, *infra,* p. 73).

The "short form merger" provided for by the Act of April 29, 1874, as amended, was followed in the transactions by which the Metropolitan Edison Company absorbed the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company. Section 23 of the Statute provides in part that any corporation, with the consent of its stockholders, is entitled:

> "* * * to sell, assign, dispose of and convey to any corporation created under or accepting the provisions of this Act, its franchises and all of its property, real, personal and mixed and that thereafter such corporation shall cease to exist

and that the said property and franchises not inconsistent with this Act shall thereafter be vested in the corporation so purchasing as aforesaid. * * *."

The Circuit Court of Appeals for the Second Circuit in its opinion in the case of *General Gas & Electric Corp., supra,* sustained the contention of the Commissioner of Internal Revenue that in the years in question a technical merger could only be effected by complying with the provisions of the Act of May 3, 1909, for the reason that the provisions of that Act alone imposed liability by operation of law upon the successor corporation for the debts and liabilities of the absorbed corporation. Moreover, the Circuit Court of Appeals for the Second Circuit found that a transaction consummated in accordance with the provisions of the Act of 1874, as amended, constituted a sale and that the successor corporation did not succeed by operation of law to the debts and liabilities of the predecessor corporation. With this holding the Respondent cannot agree since it is believed that the same is not a correct interpretation of the law of Pennsylvania, and that the court below properly found that a transaction consummated in accordance with the provisions of the Act of 1874, as amended, did constitute a true merger.

A discussion of the proper construction to be placed upon provisions of Section 23 of the Act of 1874 logically divides itself into several parts.

1. General Definition of the Term "Merger."

In order to determine whether or not the transactions by which the Metropolitan Edison Company acquired the assets and liabilities of the two affiliated companies was a merger, it will be helpful to define the term as used by the courts.

There is a definite distinction between a "consolidation," "merger" and "sale" although the same has not always been observed by the legislatures in drafting statutes or by the courts in writing opinions. This fact has resulted in considerable confusion.

A "*consolidation*" is a combination of two or more corporations by which the property, rights and privileges and franchises of all the consolidating corporations are united in a single new corporation, the consolidating corporations losing their separate corporate identities. 15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Section 7041, pp. 6-8.

A "*merger*" is the absorption of one or more corporations by another, the former ceasing to exist and the latter retaining its corporate identity with the added capital, franchises and powers of the merged corporation or corporations. "It is the uniting of two or more corporations by the transfer of property to one of them, which continues in existence, the others being merged therein." 15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Section 7041, pp. 7-8.

A "*sale*" is a transfer of property for a consideration, both the buying and selling corporations retain-

ing their corporate existence. "Where there is a mere sale or transfer of the assets to another corporation a new corporation is not created, and the respective companies still remain distinct legal entities." 15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Section 7044, p. 16.

B. PENNSYLVANIA CASES HOLD THAT A MERGER MAY BE ACCOMPLISHED UNDER THE PROVISIONS OF SECTION 23 OF THE ACT OF 1874, AS AMENDED.

Bearing in mind the distinction between a "merger," a "consolidation" and a "sale," let us proceed to an analysis of the Pennsylvania statutes and the decisions interpreting the same.

The Act of May 3, 1909, does not provide for a "*merger*" at all and only provides for a "*consolidation.*" It provides that a joint agreement shall be entered into, setting forth the "name of the *new* corporation," * * * "the *first* directors and officers," * * * "the manner of *converting the capital stock of each of said corporations into the stock of the new corporation,*" and that "new letters patent" shall be issued thereon. It is clear, therefore, that although the Act of 1909 uses the terms "merger and consolidation" it effects a combination of two or more corporations into a single *new corporation* for which new letters patent must be issued and the stock of which must be substituted for the stock of the old corporations. Since the Act creates a *new corporation* in place of all the old corporations com-

oined thereunder and does not provide for the *urvival of one of the old corporations* with the dded franchises, powers and property of the others, t is clear that this is a *"consolidation"* statute and ot a *"merger"* statute.

The Act of April 29, 1874, as amended definitely provides a procedure by which the property, rights and franchises of one corporation may be united with those of another, the latter continuing its existence while the former, by operation of the statute, ceases to exist.

The Act of 1909 and the Act of 1874, as amended, were both repealed by enactment of the new Corporation Law of 1933 which substituted therefor new statutory provisions for mergers and consolidations clearly distinguishing between the two.

In *Pennsylvania Corporation Laws of 1933,* the following annotation by E. Russell Stockley, Esquire, Special Deputy Attorney General and draftsman of the Act of 1933, appears on page 104 as a note to Sec. 901:

> "As used in the Act of 1909, the words 'consolidate' and 'merge' were used synonymously, whereas such works technically, have different meanings. In a merger, only one of the constituent corporations survives whereas the others lose their identities; while in a consolidation all the constituents lose their identities and a new corporation springs up in their place. This Act, (referring to the 1933 Act) like the Uniform Act and the Acts of the states above listed, makes a

clear distinction between a merger and a consolidation."

Mr. Stockley again in the last two sentences of his last two "comments" Section 311 of the *Pennsylvania Corporation Laws of 1933,* page 39 says:

> "* * * This provision of the Act provides a statutory procedure for the voluntary sale of the corporation property and assets, executing its franchises, and makes no change in the existing law. *It does not, however, authorize or have the effect of a merger similar to that formerly authorized by Section 23 of the Corporation Act of 1874 as amended."* (Italics added.)

As has been pointed out, the Act of 1874, as amended, was the only law of Pennsylvania under which a merger could be effected prior to the new Corporation Law of 1933. If the transactions by which the Metropolitan Edison Company absorbed the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company had taken the place after the Corporation Act of 1933 became effective and the merger had been consummated under the provision of Article IX thereof, there would be no question but that the transactions were statutory mergers. The transactions by which the Metropolitan Edison Company absorbed its four affiliates in question, however, took place in accordance with the Act of 1874, as amended. The result of such a transaction has been

peatedly held by the courts of Pennsylvania to be "merger."

In *Bly* v. *White Deer Mountain Water Co.*, 197 a. 80, the Supreme Court of Pennsylvania held at certain utility corporations could carry on their usiness only in the town, borough, city or district which they were located and not in territory djacent thereto. The practical result of this decision as that it became necessary for some utility companies to form a different corporation in other unicipal districts where present or future operaons might be contemplated. It being important to onstruct a separate operating plant in each district or which a charter had been granted, a plan was evolved to unify the corporations so that the business ould be carried on in substantially the same manner s if the charter of one corporation authorized it o operate in all the districts. The Legislature had rescribed two methods by which such unification ight be effected: (1) merger under the Act of pril 29, 1874, as amended or (2) consolidation nder the Act of 1909.

As the effect of the Act of 1874, as amended, was to reserve the identity or existence of one corporation offered certain advantages over the creation of a ew corporation under the Consolidation Act of 1909, nd was therefore largely employed. The two methods ecame distinguished by the respective descriptive, ut untechnical names of "short form" and "long orm" merger.

In *Pennsylvania Utilities Co.* v. *Public Service Commission,* 69 Pa. Sup. Ct. Rep. 612, Judge Kephart, now Chief Justice of the Supreme Court of Pennsylvania, made the following statement concerning the necessity of unifying the charters of such utility companies and recognized the fact that the merger resulting under the Act of 1874, as amended (which he called the Purchase Act of 1876, presumably because one of the steps in effecting the merger took the form of a sale) p. 614:

> "The question presented by this and a number of other appeals now before the court is of considerable importance to utility companies in the Commonwealth. After the decision in the case of Bly *v.* White Deer Mt. Water Company, 197 Pa. 80, there was a great effort by certain utilities to secure charters for the municipal districts they deemed necessary to their present and future plan of development. These concerns found it impossible, because of their great economic waste, to construct separate operating plants in each of the districts for which charters were secured. The legislature had supplied a way by which the charters might be unified and very much the same result obtained as though a charter for more than one district had been permitted. The Purchase Act of 1876 was largely employed. See Hey *v.* Springfield Water Co., 207 Pa. 38; Commonwealth *v.* Lumber City Water Co., 225 Pa. 317; Greensburg Boro. *v.* Westmoreland Water Co., 240 Pa. 485; and a list of authorities there referred to. *As a legal consequence the purchase act differs but little from the merger act which is used to some extent to consolidate companies.*" (Italics added.)

In *York Haven Water and Power Company et al.* v. *Public Service Commission of Pennsylvania et al.*, 287 Pa. 241, 134 Atl. 419, the question before the Court concerned the right of an electric light, heat, and power company to merge with an hydro-electric or water power company. The Court held that the merger could not be accomplished until the right of the hydro-electric company to furnish water to the public (which was not common to both companies) was legally discarded and in the course of the opinion Kephart, *J.*, said:

> "There are two forms of consolidation in Pennsylvania, a short and a long form merger. These are accomplished by the Act of 1876, as amended, and the Act of 1909. The Act of 1876, P. L. 33, as amended, provides that such sale may take place if the 'franchises are not inconsistent' with this act. And the merger Act of 1909, P. L. 408, permits consolidation between corporations 'transacting the same or similar lines of business.' * * * A sale or merger, under the Act of 1876, with its amendment, or the Act of 1909, which is practically the same, cannot take place until the company legally discards the offending power."

The Act of 1876 mentioned by the Court is the Act of 1874, as amended by the Act of April 17, 1876, Section 5 and the Act of June 2, 1915, under which the transactions in the case at Bar were effected.

The language used by Judge Kephart in *Pennsylvania Utilities Company* v. *Public Service Commission, supra,* illustrates the confusion in the use of

terms to which the courts fall prey, but indicates the recognition by the Supreme Court of Pennsylvania that transactions effected under the Act of 1874, as amended, and under the Act of 1909 are "practically the same."

In the latest utterance of the Supreme Court of Pennsylvania (*Northern Pennsylvania Power Co. and Metropolitan Edison Co.* v. *The Pennsylvania Public Utility Commission,* filed January 26, 1939, not yet reported), Mr. Justice Schaffer said, in referring to proceedings under the Act of 1874 as amended:

> "The Pennsylvania Public Utility Commission refused to allow the Northern Pennsylvania Power Company to sell its franchise and all the property owned by it, to Metropolitan Edison Company, and *thereby to bring about a merger of the former with the latter.* * * * *We are of opinion that the sale and consequent merger* will not adversely affect the public interest, and the action of the Commission in refusing its approval thereof was arbitrary and unreasonable." (Italics added.)

As the above discussion shows, the Pennsylvania cases have held that the Act of 1874, as amended, is a merger statute and that transactions consummated thereunder are known in Pennsylvania as "short form mergers" as distinguished from "long form mergers" effected under the provisions of the Act of 1909.

Not only have the Pennsylvania courts recognized that the Act of 1874, as amended, is a merger statute, but transfers accomplished in accordance with the

provisions of that Act meet all of the tests of a strict merger as set forth in the case of the *American Gas and Electric Co.* v. *Commissioner,* 85 F. (2d) 527 C. C. A. 2, where the Circuit Court of Appeals for the Second Circuit stated as an essential of such a merger as would entitle the successor corporation to claim deductions of the unamortized bond discount and expense of the merged corporation, that the merged corporation shall cease to exist and that the successor corporation must, by operation of law, become responsible for the liabilities of the merged corporation.

C. A TRANSACTION CONSUMMATED UNDER THE ACT OF 1874, AS AMENDED, IS A MERGER AND NOT A SALE SINCE THE TRANSFEROR CORPORATION CEASES TO EXIST.

Section 23 of the Act of 1874, as amended specifically provides that a corporation which sells, assigns, or conveys to another corporation its franchises and property shall thereafter "*cease to exist* and * * * the said property and franchises not inconsistent with this Act shall therefore be vested in the corporation so purchasing as aforesaid * * *."

In this connection the court below in this case, at page 810 of the Reports said:

> "Both the short and long form statute are equally explicit in providing that the absorbed corporation ceases to exist. It would, therefore, appear that the effect of a merger under both statutes is the same in this respect."

In contending that the transactions in question were sales the Petitioner relies upon the following

statement of Kephart, *J.*, in *In Re Buist's Estate*, 297 Pa. 537, 147 Atl. 606:

> "Care should be taken to distinguish consolidations from proceedings under the Act of 1876, P. L. 33, often referred to as a 'short form merger' (See York Haven W. & P. Co. v. Pub. Ser. Com., 287 Pa. 241); its operation in reality effects a sale of all the company's assets."

The question before the Court in the above case involved the rights of a life tenant, receiving the income from a trust, to certain stock received by the trust upon the merger of a number of banking institutions into the Philadelphia National Bank under the Act of Congress empowering national banks to consolidate. All that Kephart, *J.*, intended to point out in that portion of his opinion above quoted was that the Act of 1876, amending the Act of 1874, did not provide for consolidations but only for mergers which were effected through a transfer by one corporation to another of "its franchises and all its property, real, personal and mixed,"—the transaction taking the form of a sale, thereby distinguishing such a transaction from a consolidation of national banks under the Act of Congress which is not accomplished through the form of a sale. The observation made by Kephart, *J.*, with reference to the Act of 1874, as amended, should not be taken as a holding by the Supreme Court of Pennsylvania that the Act does not effect a merger but only that a transaction under the Act effects a merger by employing as one of the steps a form of "sale."

In 8 *Thompson on Corporations,* Third Edition, Section 6012, page 66, the learned author says:

> "* * * In a merger of two or more corporations, one of the merged corporations survives; that is, the merger consists in the uniting of two or more by the transfer of all the property to some one of the existing corporations, which continues its existence, while the others are swallowed up by or merged in the one that exists. And in this respect it differs from a consolidation, wherein * * * all the corporations terminate their existence and become parties to a new one. *The true test as to whether or not there has been a merger, is as to whether the existence of one of the corporations has been preserved and the other has ceased to exist.*" (Italics added.)

In Section 6019, at page 78, the author further says:

> "* * * But, as already noticed, and as judicially held, consolidation may be effected by the purchase of all the property and franchises of one corporation by another * * *"

In 15 *Fletcher Cyclopedia Corporations* (permanent edition), Section 7044, pp. 16-17, the author says:

> "* * * if the coming together of two corporations under the authority of law be in fact consolidation * * * it is of no consequence by what name the act is characterized nor is it of any consequence by what steps the result has been effected, *and one of those steps may take the shape of bargain and sale.*" (Italics added.)

If it is borne in mind that a merger may be accomplished in the form of a bargain and sale, a great deal of the confusing language in the cases

is explained. It is submitted that the contention of the Petitioner and the decision of the Circuit Court of Appeals for the Second Circuit in the *General Gas & Elec. Corp.* case are based upon the failure to observe this fact. It is true that under the Pennsylvania "short form" merger, one step takes the form of a sale. The important point to note, however, is that the "sale" under the Pennsylvania Law is merely a means of effecting the merger of corporations. That this fact is important is shown by the case of *Bassick* v. *Commissioner of Internal Revenue*, 85 Fed. (2d) 8 (C. C. A. 2) (certiorari denied 299 U. S. 592), where the Court said: "For Income Tax purposes, the component steps of a single transaction cannot be treated separately."

In *Chicago Santa Fe and California Railway Co.* v. *Ashling*, 160 Ill. 373, 380, 381, 43 N. E. 373-375, the Chicago and St. Louis Railway Co. transferred all of its properties and franchises by deed of conveyance to the appellant. The question before the Court was whether this transaction which was in the form of a sale was not in fact a "consolidation." In holding that the transaction was a "consolidation" and that the defendant was liable for the torts of its predecessor from which it purported to "buy" assets, the Court said:

> "* * * It is true, that what was done must be considered in order to determine whether there was a consolidation or not; but we must look to the results accomplished, rather than to the means, steps or procedure by which those results have been attained.

"* * * *There is no magic in words. Merely calling the transaction a purchase and sale would not prevent it from being a consolidation.* It cannot be supposed, from the nature of this transaction, that it was expected that the St. Louis Company should continue its active corporate existence after divesting itself of all its property, corporate rights and franchises and stockholders." (Italics added.)

In *Continental Trust Company* v. *Toledo St. L. & K. C. R. Co.*, 82 Fed. 642, 652, Mr. Chief Justice Taft, then Circuit Judge, considered the effect of an Illinois Statute which provided:

"That all railroad companies now organized, or hereafter to be organized under the laws of this state, which now or hereafter may be, in possession of and operating in connection with or extension of their own railway lines any other railroad or railroads in this state, or in any other state or states, or owning and operating a railroad which connects at the boundary line of this state with a railroad in another state, *are hereby authorized and empowered to purchase and hold in fee simple* or otherwise and to use and enjoy, the railway property, corporate rights and franchises of the company or companies owning such other road or roads upon such terms and conditions as may be agreed upon between the directors and approved by the stockholders," etc. (Italics added.)

Concerning the effect of this statute the learned Judge said:

"Although this act uses the word 'purchase,' it plainly contemplates consolidation, and this is the holding in Illinois * * *."

The authorities clearly support the proposition that either a merger or consolidation may be accomplished even though one of the steps in effecting the merger may be a sale. The true test in determining whether or not a certain transaction between two or more corporations constitutes a merger is whether the existence of one of the corporations has been preserved and the others have been swallowed up by or merged in the one that continues in existence.

The "short form" merger under Pennsylvania law meets all the essential legal requirements of a merger, which was defined by Judge Augustus N. Hand in *Cortland Specialty Co. et al.* v. *Commissioner of Internal Revenue,* 60 F. (2nd) 937 (1932) (Cert. Den. 288 U. S. 599, 77 L. Ed. 975), as follows:

"Reorganization, merger, and consolidation are words indicating corporate readjustments of existing interests. They all differ fundamentally from a sale where the vendor corporation parts with its interest for cash and receives nothing more. * * * *A merger ordinarily is an absorption by one corporation of the properties and franchises of another whose stock it has acquired. The merged corporation ceases to exist and the merging corporation alone survives.* A consolidation involves a dissolution of the companies consolidating and a transfer of corporate assets and franchises to a new company. * * * A sale of the assets of one corporation to another for cash without the retention of any interest

by the seller in the purchaser is quite outside the objects of merger and consolidation statutes." (Italics added.)

Following the completion of the transfer by the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company and the Pennsylvania Edison Company of all of their assets to the Metropolitan Edison Company in accordance with the provisions of the Act of 1874, as amended, the transferor corporations in the case at bar, in accordance with the express provisions of the statute, ceased to exist and were, in fact, dissolved. Of course, as in all cases of merger or consolidation of corporations, the absorbed corporation continues to exist for the purpose of actions pending against it. The court in *Merwine* v. *Mt. Pocono Light & Improvement Co.*, 304 Pa. 517, 156 A. 150 (which will be discussed in greater detail hereafter), in stating that a corporation which has merged pursuant to the provisions of Section 23 of the Act of 1874 continues its independent existence could only have meant that it does so for the purpose of actions pending against it. This is true of all corporations in Pennsylvania whether merged under the "long form merger" statute or under the "short form merger" statute. Each statute expressly provides that the merged corporation shall cease to exist as an independent entity.

In the case of *Petry* v. *Harwood Electric Co.*, 280 Pa. 142, the Supreme Court of Pennsylvania had

before it the question of the effect of a merger and said at page 146:

> "That, in the domain of the practical, a dissolution resulted from the merger there can be no doubt; after it was accomplished the defendant's existence ended, so far as being a going, operating entity is concerned; its property and good will passed into the control and ownership of the new corporation and it ceased to do business. The effect was to wipe out the merging companies and fuse them all into the new one created.
>
> "It is argued by appellant that a dissolution did not take place, because what resulted has none of the attributes of a dissolution, as there was no liquidation and winding up of the company, no sale, no fund raised, no payment of indebtedness and no surplus for distribution among stockholders, that even the separate existence of the company was not terminated, since the merger statute provides that the constituent companies may be deemed 'to be in existence' to preserve the rights of creditors and liens upon the property."

The court, however, came to the conclusion that the transaction constituted a merger and it is therefore clear from this decision that even though a constituent company in a merger may be deemed "to be in existence" to preserve the rights of creditors, the effect of the merger for all other purposes is to wipe out the merging company and fuse it into the new one.

Since under the Pennsylvania law the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company and the Pennsylvania Edison Company

ceased to exist as independent entities when they were absorbed by the Metropolitan Edison Company under the Act of 1874, as amended, the transaction in each case was a merger and not a sale, and the existence of the merged companies was carried forward and continued in the successor corporation.

D. As a Result of a Merger Effected Under the Provisions of the Act of 1874, as Amended, a Transferee Corporation Succeeds by Operation of Law to the Liabilities of the Transferor Corporation.

In its opinion in the *General Gas & Elec. Corp.* case, *supra,* the Circuit Court of Appeals for the Second Circuit in coming to the conclusion that the Pennsylvania "short form merger" constitutes a sale and that creditors of the transferor can hold the transferee liable only on principles of fraudulent conveyance and to the extent of the value of assets received, relies upon the case of *Merwine* v. *Mt. Pocono Light & Improvement Co.,* 304 Pa. 517, 156 A. 150.

In that case the appellant had sued to recover damages for personal injuries. The defendant's attorney filed a suggestion setting forth that the property and franchises of the defendant had been conveyed to the Pennsylvania Power and Light Co. in *proceedings under the Act of 1874, as amended;* they alleged that under the Act the defendant had ceased to exist and therefore prayed that the action against it should be abated. Plaintiff filed an Answer and prayed that

a Rule be allowed to show cause why the Pennsylvania Power and Light Company should not be substituted as defendant. The Court below denied the prayer of the plaintiff and abated the action.

On appeal, the Supreme Court of Pennsylvania held that termination of the corporate existence of the defendant company under the Act of 1874, as amended, did not abate the action.

Counsel for the appellant had contended in his brief (page 518 of Opinion) that "The transaction was a merger, not a sale." In considering this contention the Court said at pages 524-525:

> "Although we need not decide the point, it is proper to call attention to the fact that the pleadings indicate that the Pennsylvania Power & Light Company took over the property of defendant under circumstances warranting a finding, upon evidence produced to support the allegations in the pleadings, *that the transaction between the two corporations was in reality a merger, or such union of interests as, in law, caused the buying corporation to assume defendant's obligations.* There is much to show that the purchase was attended by an intimacy of interest tending to render the transaction, in so far as the Pennsylvania Power & Light Company's interest was concerned, a purchase *cum onere.* For instance, it is averred that, at the time of the commission of the alleged negligent acts on the part of the Mount Pocono Light & Improvement Company, it was affiliated or associated with the Pennsylvania Power & Light

Company to the extent that both companies were managed, operated and controlled under the same management and system. It is admitted that the common stock of both companies was owned by the same holding company, and, by defendant's own showing, thirteen of the same persons were officers or directors in both companies. It further appears that both companies operated from the same office. Plaintiff states that the business of the Mount Pocono Company was conducted by the agents, servants and employees of the Pennsylvania Power & Light Company; that after the sale, the power company took over and operated the business formerly conducted by defendant; and that the sale was merely a formality giving effect to a union of the companies which had in reality occurred previous to the accident upon which the suit is based." (Italics added.)

Attention is particularly called to that portion of the above statement appearing in italics whereby the court definitely states that a transfer by a corporation (under the procedure prescribed under the Act of 1874, as amended) of its franchises and property to "the buying corporation," with which it is affiliated, is simply a formality and the transfer in reality is a merger of the two companies. All that the Court actually held in the *Merwine* case was that the action brought against the merged subsidiary prior to the merger did not abate, and that if the plaintiff recovered judgment against the Mt. Pocono Company she could "levy where defendant's assets liable for the judgment may be found."

The Circuit Court of Appeals for the Second Circuit stated in its opinion in the *General Gas & Elec. Corp.* case, *supra,* that the transfer of the property of the Mt. Pocono Company to the successor corporation might be set aside as being in fraud of creditors and in that sense only did the successor corporation succeed to the liabilities of the absorbed corporation. This, however, is not the procedure under the law of Pennsylvania.

A Pennsylvania corporation which has acquired the assets of another corporation in accordance with the provisions of the Act of 1874 as amended, succeeds to the liabilities of the transferor, not by reason of any application of the doctrine of fraudulent conveyances, but by reason of the fact that in Pennsylvania such liability is, by operation of law, an inherent part or consequence of a merger.

The Statute of 13 Elizabeth, Chapter 5, dealing with fraudulent conveyance applies to colorable sales made for the purpose of delaying or hindering creditors and it declares such sales to be "utterly void." This Statute has no bearing on mergers or consolidations which are authorized by statute. The transaction in the *Merwine* case and in the case at bar were specifically authorized by the Act of 1874. Section 23, as amended and are therefore lawful and not "utterly void" under the Statute of Elizabeth.

The Statute of Elizabeth may apply to ordinary sales of corporate property such as those referred to in the following cases cited by Petitioner in his brief:

Ringler v. *Atlas Portland Cement Co.*, 301 Pa. 176, 151 A. 815;
Mount Union Borough v. *Kunz*, 290 Pa. 356, 139 A. 118;
Maxler v. *Freeport Bank*, 275 Pa. 510, 119 A. 592;
Koehler v. *St. Mary's Brewing Co.*, 228 Pa. 648, 77 A. 1016;
Carr v. *Rochester Tumbler Co.*, 207 Pa. 392, 56 A. 945.

In *Montgomery-Web Company* v. *Dienelt*, 133 Pa. 585, 19 A. 428, the Court held an ordinary sale of property by a corporation to be void, just as "in the case of an individual, a transfer to his wife or his agent, or anybody who should merely represent himself under another name, would be unquestionably void against creditors."

In cases of ordinary sales in fraud of creditors the creditors may (*a*) pursue the assets in the hands of the new company through judgment against the old company on theory that the sale is void or voidable, or (*b*) by proper proceedings fasten a constructive trust as to such assets on the new company as Trustee (*Halpern* v. *Grabosky*, 296 Pa. 108, p. 112, 145 A. 834), or (*c*) file a bill in equity to discover assets and impose liability upon the theory that equity regards the property as a trust for the payment of existing debts, and will follow it on behalf of creditors until it gets into the hands of innocent purchasers for value (*Montgomery-Web Company* v. *Dienelt*, 133 Pa. 585, p. 596, and *Mt. Union Borough* v. *Kunz*, 290 Pa. 356, p. 362).

In the latter case while the transfer of the water works was made under the Act of 1874, Section 23, as amended, the transaction was an *ordinary sale,* not a *merger,* as the purchase price was $60,000 in cash and other considerations. There was no amalgamation of interests, as there must be in a merger; the old owners did not divorce themselves from the business.

The Act of 1874, as amended, authorizes out-and-out sales, like the water works sale, or mergers like that in the *Merwine* case and in the case at bar where the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company and the Pennsylvania Edison Company transferred all of their property rights and franchises to the Metropolitan Edison Company in exchange for stock so that the interests of the old companies were amalgamated and merged with those of the surviving corporation. The old companies not only ceased to do business, but by the very nature of the transfer ceased to exist. In so doing the Metropolitan Edison Company took the property of the transferor corporation *cum onere* (*Merwine* v. *Mt. Pocono Land Improvement Company* case, *supra*), although an action pending against the old companies would not abate.

Being a merger under the Pennsylvania law, the transfer of the assets of the absorbed corporations to the Metropolitan Edison Company was not void, having been accomplished in accordance with the statutory provisions of Section 23 of the Act of 1874,

as amended. There could be no occasion to file a bill in equity to discover assets, as in the case of a fraudulent conveyance, since there was no concealment requiring the discovery. The transaction was entirely open and above-board and the facts readily ascertainable by all parties in interest.

The Supreme Court of Pennsylvania has held that the remedy of creditors of a *merged* corporation is to follow the assets into the hands of the surviving corporation. Thus in *Berkovitz's Appeal,* 319 Pa. 397, at page 407, the Court said:

> "* * * we have also decided in other cases that creditors of one corporation may follow the property or assets of such corporation into a new corporation *where there has been a merger,* or, in cases of fraudulent transfer. See Halpern *v.* Grabosky, 296 Pa. 108, 111; Merwine *v.* Mt. Pocono, 304 Pa. 517, 522; Delphia Knitting Mills Co. *v.* Richards, 62 Pa. Superior Ct. 9, 12." (Italics added.)

As the court in the above case pointed out, where there is a merger the creditors of one corporation may follow the property or assets of that corporation into the new corporation. In this respect the remedy is the same as that afforded creditors in the case of a fraudulent transfer. Attention, however, is called to the fact that while the remedial procedure may be the same in the case of a merger as in the case of a fraudulent transfer, the basis for the remedy in one is not the same as the basis for the remedy in the other. A creditor in the case of a merger is given

certain remedies as a legal incident of the merger, namely, that the successor corporation is liable for the debts of its predecessor while in the case of a fraudulent transfer by way of sale or otherwise, a creditor is granted equitable relief. In the case of a merger there is no necessity of resorting to equitable principles.

In the case of *Merwine* v. *Mt. Pocono Land Improvement Company, supra,* the Court said that the plaintiff having secured judgment could *"levy* where defendant's assets liable for the judgment may be found." The direction of the Court to "levy" could only mean one thing—the issuance of a writ of *fieri facias* and the seizure by the Sheriff of the property owned by the Mt. Pocono Company and now in the hands of the Pennsylvania Power and Light Company. The Supreme Court of Pennsylvania made this perfectly clear in *Weinroth* v. *Homer B. and L. Association,* 310 Pa. 265, p. 270, where, in referring to the *Merwine* case it said: "The court there directed plaintiff, if he recovered judgment, to pursue the property of defendant in possession of the merged company." Since the transfer of the property of one corporation to another corporation under the provisions of the Act of 1874, as amended, is authorized by statute, the property upon its transfer is, in fact, the property of the transferee or surviving corporation and cannot either in law or in equity be considered the property of the old corporation. Therefore, to say that upon a merger a creditor of the transferor corporation can pursue the property for-

nerly owned by it into the hands of the merged company can only mean that the merged company acquires the property of a transferor corporation subject to all of its debts and liabilities.

There can be no doubt that under the Pennsylvania law when one corporation by merger succeeds to the assets of another, it likewise succeeds to all of the other's rights and is bound as well by all its obligations. That such liability exists was recently recognized by the Supreme Court of Pennsylvania in *Commonwealth* v. *Merchants National Bank of Allentown*, 323 Pa. 145, 185 A. 823,* where the Court said:

> "While there is general agreement in applying the rule of implied liability in cases of *merger* or *consolidation* or *purchase*, the courts have not always agreed on the reasons for doing so." (Italics added.)

As has already been pointed out, a merger under the Act of 1874, Section 23, as amended, has been considered by the Supreme Court of Pennsylvania as being practically the same as a consolidation under the Act of 1909.

The Act of 1909 (Title 15 Purdon's Statutes, Sections 421-425) contains the following provision:

> "Section 423. Effect of merger * * *
>
> "* * * Provided, That all rights of creditors and all liens upon the property of each of said corporations shall continue unimpaired, limited

*For a further discussion of this case see page 43, *infra*

in lien to the property affected by such liens at the time of the creation of the same, and the respective constituent corporations may be deemed to be in existence to preserve the same; and all debts not of record, duties, and liabilities of each of said constituent corporations shall thenceforth attach to the said new corporation, and may be enforced against it to the same extent and by the same process as if said debts, duties, and liabilities had been contracted by it."

The effect of the decisions in the *Merwine* and other cases above mentioned is to make the law with respect to the rights of creditors of merged corporations identically the same as the statutory rights of creditors of constituent corporations in consolidations effected under the Act of 1909.

It is a general proposition that where a corporation is absorbed by another and transfers its assets in consideration for the shares of stock in the transferee corporation the latter is liable for the debts and liabilities of the former, regardless of whether the transaction takes the form of a strict merger or not. See 15 *Fletcher Cyclopedia Corporations* (Perm. Ed.) Section 7127, *15 A. L. R. 1112, 30 A. L. R. 558, 39 A. L. R. 143.* The Pennsylvania cases support this proposition.

Contrary to the opinion of the United States Circuit Court of Appeals for the Second Circuit rendered in the *General Gas & Electric Corp.* case, *supra,* the respondent submits that the law of Pennsylvania gives creditors of a merged or constituent corporation a plain, adequate and complete remedy at law against

the surviving or new corporation for the debts and obligations of the absorbed corporation. However, such a right is not a *sine qua non* of a technical merger or consolidation for the reason that it is generally held that if a creditor does not have an adequate remedy at law he may proceed in equity to enforce his rights against merged or constituent corporations. See Section 7170-7171 of *Fletchers Cyclopedia Corporations* (Perm. Ed. Vol. 15).

Whether or not the creditors of a merged or consolidated corporation have the right to enforce their claims at law or in equity is immaterial so long as the successor corporation remains liable for the same. The petitioner in his brief before the Circuit Court of Appeals (omitted here) naively suggested that liability would flow under circumstances in this case "under equitable principles and not by operation of law." Whether such liability be characterized as an assumption of liability by operation of law or upon the application of equitable principles is immaterial. It is not from what the procedure is called that the assumption of liability flows, but it is the result of the procedure.

Where, therefore, a Pennsylvania corporation merges with or absorbs another corporation, each having substantially the same stockholders, the transfer of the assets from the old corporation to the continuing corporation carries with it by *operation of law* the liability for the debts of the old corporation even though there is no contract or agreement

by the continuing corporation to assume such debts. The assumption by operation of law of such liability completely meets the test prescribed in the case of the *American Gas and Electric Company* v. *Commissioner*, 85 Fed. (2d) 527.

In the argument which has here been presented the respondent is sustained by the opinion of the Court below which said on page 810 of the Reports:

> "We are convinced that the transactions, by means of which the petitioner absorbed the subsidiaries here involved, partook of all of the essential elements of a merger (Chicago, S. F. & C. Ry. Co. *v.* Ashling, *supra*), and that the petitioner is entitled to the deduction claimed for 1928. *American Gas & Elec. Co.* v. *Comm.*, 2 Cir., 85 F. 2d 527; *New York Cent. R. Co.* v. *Commissioner*, 2 Cir., 79 F. 2d 247, certiorari denied 296 U. S. 653, 56 S. Ct. 370, 80 L. Ed. 465; *Western Maryland Ry. Co.* v. *Commissioner*, 4 Cir., 33 F. 2d 695; *American Gas & Elec. Co.* v. *U. S.*, 17 F. Supp. 151, Ct. Cl."

II.

The Transaction by Which the Metropolitan Edison Company Acquired the Assets of the Metropolitan Power Company and Assumed its Obligations was a De Facto Merger and the Former Company is Entitled to Deduct the Unamortized Bond Discount and Expense with Respect to the Latter's Bonds upon Their Redemption.

In its income tax return for 1927 the Metropolitan Edison Company deducted unamortized discount and

expense with respect to certain bonds of the Metropolitan Power Company which it had retired in that year. Particular attention must be given to the transaction by which the Metropolitan Edison Company purchased the assets and took over the liabilities of the Metropolitan Power Company since that transaction differed in certain respects from the transactions by which the Metropolitan Edison Company absorbed the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, and the Pennsylvania Edison Company.

As stated by the petitioner in his brief, the circumstances relating to the redemption of those bonds in general resemble those relative to the redemption in 1928 of bonds issued by other corporations whose assets the taxpayer acquired, except for the fact that the agreement by which the taxpayer acquired the assets and assumed the liabilities of the Metropolitan Power Company was not entered into pursuant to any Pennsylvania Statute. Therefore, in so far as the deduction with respect to the bonds of the Metropolitan Power Company was concerned, the provisions of Section 23 of the Act of 1874 as amended (Section 595, Title 15 of Purdon's Pennsylvania Statutes, Appendix B, *infra*, p. 73) are not involved.

It appears from the facts that the Metropolitan Power Company was formed originally to provide the parent company (the taxpayer) with additional

electrical energy, it being formed as a separate cor poration merely for the purposes of financing th construction of a power plant through a first mort gage (R. 32). Its entire output was contracted fo by the respondent for a consideration which wa sufficient to enable the Power Company to earn a gross revenue at least sufficient to meet all costs o operation and other charges other than for capita purposes including maintenance, depreciation, taxes and interest on indebtedness (R. 32). Substantially all of the stock of the Power Company was owned by the respondent and in the method of operation of its electric generating plant the Power Company was simply a department of the respondent (R. 32). Immediately upon the organization of the Power Company the respondent purchased and guaranteed and sold to the public all of the bonds issued by the Power Company; purchased all of the stock and loaned to the Power Company on an open account approximately $3,000,000 and except for the $3,250,000 of bonds, the respondent was practically the sole investor and creditor (R. 32).

The bonds were originally issued at 90 to the respondent which immediately endorsed them and guaranteed them as to principal and interest and sold them to the public at the same price (R. 32).

In February, 1927, the Power Company transferred to the respondent all of its assets and liabilities as they stood upon its books and a deficit in operations was charged against the surplus of the respondent

(R. 32). The respondent surrendered the capital stock of the Metropolitan Power Company which it owned for cancellation and the Power Company became inactive about February 28, 1927, although it was not formally dissolved until January 28, 1928 (R. 32).

At the time of the transfer in February, 1927, the respondent assumed the $3,250,000 liability under the Power Company's bonds which had been guaranteed by respondent at the time of issuance. The respondent cancelled the debt of the Power Company to it in the amount of approximately $3,000,000 (R. 32).

The respondent redeemed the bonds at a premium during the latter part of 1927, at which time the unamortized bond discount and expense amounted to $308,097.90 (R. 32-33).

It was admitted before the Board (R. 39-40) and in the Court below (R. 54) that the transfer of the assets from the Power Company to the Metropolitan Edison Company did not take place pursuant to any Pennsylvania Statute. Even though there was no statutory merger involved, it is contended, however, that the transfer had all of the elements essential to a merger in that the Power Company for all practical purposes ceased to exist and the Metropolitan Edison Company was liable for its debts and obligations. In short, there was a *de facto* merger entitling the taxpayer to the deductions claimed. The Court below

agreed with the taxpayer's position on this point, and said (R. 54):

> "The analysis of this transaction shows: (1) that the Power Company transferred all of its assets to the petitioner; (2) that the petitioner was an existing corporation and continued to exist; (3) that the Power Company, though it did not automatically cease to exist upon the completion of the transaction, did discontinue all operations and was left without stockholders or property of any sort, and (4) that the petitioner, both by contract and operation of law, became liable for the debts of the Power Company. 14 C. J. 970; 15 Fletcher Cyclopedia Corporations, section 7127; *In re* Harr, *supra; In re* Buist's Estate, *supra;* Commonwealth *v.* Merchants Nt. Bank of Allentown, *supra.*
>
> "The only difference between the above procedure and that followed by the petitioner under the 'short form merger statute' with reference to the 1928 deduction was that the Power Company continued to exist nominally, while the Cumberland, York-Haven, Hanover and Pennsylvania Edison Companies automatically under the statute ceased to exist except as noted above. This was a mere technical, and not a practical or substantial difference, and should not determine the rights of the parties. Moreover, the transfer by the Power Company of all of its assets and cancellation of all of its stock effected its *de facto* dissolution. (14 (a) C. J. 1117; Lauman *v.* Lebanon Valley R. Co., 30 Pa. 42; Reynolds *v.* Cridge, 1 Dist. 693; 11 Pa. C. C.

306; Commonwealth *v.* Altoona & P. C. R. Co., 32 Pa. C. C. 449; Skirvin Operating Co. *v.* Southwestern Electric Co., 174 Pac. 1069, 15 A. L. R. 1104, 1110), and its formal dissolution in January 1928 was only a declaration of that fact. 14 (a) C. J. 1118."

The courts of Pennsylvania recognize *de facto* consolidations or mergers where the essential elements of such transactions are present, even though not carried out under statutory provisions. The Supreme Court of Pennsylvania recently had such a question before it in the case of *Commonwealth* v. *Merchants National Bank of Allentown*, 323 Pa. 145; 185 A. 823. The facts were that a trust company and a national bank entered into an agreement consolidating their assets without following the statutory procedure authorizing such consolidations. Subsequently, the consolidated bank was sued upon a bond which had been formerly given by the trust company. In the action on the bond the defendant consolidated bank denied liability on the bond. The Supreme Court of Pennsylvania held that there was a *de facto* consolidation and that the consolidated bank assumed the liability of the trust company on the bond. The Court said in its opinion at page 152:

"The consolidating procedure, in its Pennsylvania aspect, was irregular but certain consequences nevertheless resulted. The parties to the consolidation, when confronted with an obligation like that now involved, must meet it as if

they had complied with the statutes which would have enabled them to consolidate. If, for the purposes of this suit, we accept its contention that the consolidation was not "legal" in the respect indicated, defendant will not be permitted to deny its effect in fact: *Cochran* v. *Arnold*, 58 Pa. 399, 405; *Hamilton* v. *Clarion M. & P. R. Co.*, 144 Pa. 34, 23 A. 53; *Tibby Bros. Glass Co.* v. *P. R. R. Co.*, 219 Pa. 430, 68 A. 975.

* * * * * * *

"While there is general agreement in applying the rule of implied liability in cases of merger or consolidation or purchase the courts have not always agreed on the reasons for doing so. (Foot Note.) This appeal does not require discussion of these reasons. We cannot adopt a rule that would permit the repudiation of lawful obligations by the failure of two corporations to observe required procedural steps in uniting their property under one charter. It is sufficient to say that the declared policy of the law of this Commonwealth governing consolidation *de jure* requires similar assumption of liabilities by consolidations in fact."

It will be seen from the above case that in Pennsylvania *de facto* consolidations are recognized and carry with them all of the legal consequences and effects of a statutory consolidation even to the extent of imposing upon the consolidated company the liabilities of the constituent companies just as though the consolidation had been carried out under a statute. If there can be a *de facto* consolidation there can of

course, be a *de facto* merger, and it is contended that was the substantial effect of the transaction between the Metropolitan Power Company and the Metropolitan Edison Company under Pennsylvania law.

The Power Company never really had any substantial existence independent of the Metropolitan Edison Company. To all intents and purposes the Power Company was really an arm or branch of the parent company and had been called into existence merely for the purpose of negotiating a mortgage on a new electrical generating plant needed by the Metropolitan Edison Company. There was never any necessity of following any statutory procedure to effect the transfer of the assets and liabilities of the Power Company to the Metropolitan Edison Company for the reason that the Power Company held no public franchises. While it is true that the transaction took the form of a sale, no consideration passed since the Metropolitan Edison Company was the sole stockholder of the Power Company and the transaction amounted to nothing more than a merger of the assets and liabilities of the Power Company into the parent company. As has been pointed out heretofore, the fact that a transaction takes the form of a sale does not prevent it from being a merger. It is the result accomplished, not the means, which determines the nature of such a transaction.

Not only did the Power Company for all practical purposes cease to exist after its assets had been transferred to the parent company, but its obligations as

well became those of the parent company. As the Supreme Court of Pennsylvania said in the recent case of *Lansdowne Bank & Trust Company (In re Harr)*, 323 Pa. 380, 186 A. 120, at page 384:

> "The well settled principle applies that where one corporation purchases the business and assets of another, it succeeds to all the other's rights and is bound as well by all its obligations: *Maxler* v. *Freeport Bank et al.*, 275 Pa. 510; *Buist's Estate*, 297 Pa. 537."

Since the effect of the transaction between the Power Company and the Metropolitan Edison Company constituted a *de facto* merger, the latter company was entitled to deduct the unamortized bond discount and expense remaining at the time that the bonds of the Power Company were retired prior to maturity.

III.

Regardless of the Nature of the Transactions in This Case the Metropolitan Edison Company Actually Sustained a Loss on Account of Unamortized Bond Discount and Expense Which it is Entitled to Deduct.

Since the Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company and the Pennsylvania Edison Company were merged with the Metropolitan Edison Company under the Act of 1874, as amended, and since the absorption of the Metropolitan Power Company by the Metropolitan Edison Company was a *de facto* merger, respondent contends, for the reasons

hereinabove set forth, that the deductions claimed for the unamortized debt discount and expense at the time of the redemption of the bonds of the affiliates were properly allowable under the decisions in *American Gas & Elec. Co.* v. *Commissioner,* 85 F. 2d 527 (C. C. A. 2); *New York Central R. Co.* v. *Commissioner,* 79 F. 2d 247 (C. C. A. 2); certiorari denied 296 U. S. 653, 56 S. Ct. 370, 80 L. Ed. 465; *Western Maryland Ry. Co.* v. *Commissioner,* 33 F. 2d 695 (C. C. A. 4).

Respondent further contends, however, that regardless of the nature of the transactions involved the Metropolitan Edison Company was in any event entitled to the deductions allowed in accordance with the provisions of the Revenue Acts of 1926 and 1928, which, like previous Revenue Statutes, provide that in computing net income, corporations shall be entitled to deduct all the ordinary and necessary expense paid or incurred during the taxable year in carrying on any trade or business, all interest paid or accrued within the taxable year on indebtedness, and all losses sustained during the taxable year and not compensated for by insurance or otherwise, see Section 234 (a) (1) (2) and (4) of the Revenue Act of 1926 and Section 23 (a), (b) and (f) of the Revenue Act of 1928 (Appendix A, *infra,* p. 69).

It has been held in a number of cases that as a general rule deductions are allowable only to the taxpayer who incurred the expense or loss (*Planters Oil Co.* v. *Hopkins,* 286 U. S. 332; *Welch* v. *Helver-*

ing, 290 U. S. 111; *New Colonial Co.* v. *Helvering,* 292 U. S. 435; *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 415; *Pennsylvania Co.* v. *Commissioner,* 75 F. (2d) 719 (C. C. A. 3rd), and that therefore a corporation which purchases all of the assets of another cannot take a deduction for the losses sustained by the seller corporation. This general principle has been applied by the courts in holding that deductions for amortization of bond discount and expense are not in general allowable to a corporation which by purchase and sale for consideration has taken over the assets of the corporation which issued the bonds and assumed their liabilities. See *American Gas & Elec. Co.* v. *Commissioner,* 85 F. (2d) 527 (C. C. A. 2nd); *New York Cent. R. Co.* v. *Commissioner,* 79 F. (2d) 247 (C. C. A. 2nd), certiorari denied, 296 U. S. 653; *Western Maryland Ry. Co.* v. *Commissioner,* 33 F. (2d) 695 (C. C. A. 4th); *Turner-Farber-Love Co.* v. *Helvering,* 68 F. (2d) 416 (App. D. C.); *New York, C. & St. L. R. Co.* v. *Burnet,* 64 F. (2d) 152 (App. D. C.); *American Gas & Electric Co.* v. *United States,* 17 F. Supp. 151 (C. Cls.).

The theory on which the amortization of bond discount and expense is deductible is that the discount and expense reduce by their amount the capital realized by the company issuing the bonds, and, while they come out of the pocket of the taxpayer corporation only upon the payment of the bonds at maturity, the loss may properly be amortized over the life of the bonds. Therefore, in the case of *Helvering* v.

Union Pacific Railroad Co., 293 U. S. 282, this Court said (pp. 286-287):

> "Both commissions and discount, as the Government concedes, are factors in arriving at the actual amount of interest paid for the use of capital procured by a bond issue. The difference between the capital realized by the issue and par value, which is to be paid at maturity, must be added to the aggregate coupon payments in order to arrive at the total interest paid. Both discount and commissions are included in this difference. *If the difference be viewed as a loss resulting from the funding operation, it is one which is realized only upon the payment of the bonds at maturity.*
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> * * * * * * *
>
> * * * We think that the revenue acts, as they have been interpreted by this Court and the treasury regulations upon this and related subjects, require that this difference between receipts and disbursements of the taxpayer should, in some form, enter into the computation of his taxable income. It is a loss to the taxpayer, definite as to its date and amount, and represents a part of the cost of the borrowed capital during each year of the life of the bond issue. Cf. *United States* v. *Anderson, supra.* At least where the taxpayer's books are kept upon the accrual basis, its final disbursement may be anticipated by amortization and the amortized amount deducted annually from his gross income." (Italics added.)

It has therefore been held that when a corporation retires bonds issued at a discount, it is then entitled

to deduct the portion of the bond discount and expense which has not previously been deducted. *Gt. W. Power Co.* v. *Commissioner,* 297 U. S. 543; *San Joaquin Light & Power Corp.* v. *McLaughlin,* 65 F. (2d) 677 (C. C. A. 9th); *Helvering* v. *California Oregon Power Co.,* 75 F. (2d) 644 (App. D. C.); *Helvering* v. *Union Public Service Co.,* 75 F. (2d) 723 (C. C. A. 8th); *Helvering* v. *Central States Electric Corp.,* 76 F. (2d) 1011 (C. C. A. 2d).

The reasoning of the cases and the basis of the rule allowing a corporation which redeems bonds prior to maturity to deduct unamortized bond discount and expense is, of course, that the corporation so redeeming the bonds actually sustains a loss for which it has not been compensated and that therefore under the express terms of the Revenue Statutes such loss is deductible. The courts have, however, very properly held that where the corporation which redeems the bonds has purchased the assets and liabilities of the corporation issuing the bonds, unamortized bond discount and expense remaining at the time of redemption cannot be deducted. *Planters Oil Co.* v. *Hopkins,* 286 U. S. 332; *Welch* v. *Helvering,* 290 U. S. 111; *New Colonial Co.* v. *Helvering,* 292 U. S. 435; *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 415; *Pennsylvania Co.* v. *Commissioner,* 75 F. (2d) 719 (C. C. A. 3rd). There is a very good reason for the refusal of the courts to allow a purchasing corporation to take such deductions, namely, that in purchasing the assets of a corporation issuing bonds at a discount

e prospective loss to be sustained in the event that e bonds should be redeemed by the purchasing cor- ration prior to maturity is adjusted or compensated r in the purchase price paid for the assets of the suing corporation, and to allow the purchasing cor- ration to take such deduction upon redemption of e bonds would result in allowing the purchasing rporation the benefit of a loss which it never tually sustained. Looking at it from another point f view, to allow such deduction to a purchasing rporation would be allowing one corporation to rry over a loss which was really sustained by a redecessor.

The courts have, however, as has been pointed out nsistently, allowed a merged corporation to take ch deduction in redeeming the bonds of a pre- cessor corporation prior to maturity. The basic ason for such an allowance is that in the case of a erger the loss is actually sustained by the corpora- on redeeming the bonds and such loss was not sus- ined by the predecessor corporation nor in any ay compensated for at the time of the merger.

While the court in the case of *American Gas & lec. Corp.* v. *Commissioner,* 85 F. (2d) 527 (C. C. A.) recognized the rule that a merged corporation ay deduct the unamortized bond discount and ex- nse remaining at the time that it redeems bonds sued by its predecessor, limited that rule to strict atutory mergers. The petitioner in this case is kewise attempting to limit the rule with respect to

the deduction of unamortized bond discount and expense. The respondent, however, contends that in so limiting the application of the rule, the Court, in the *American Gas & Elec. Co.* case, *supra,* and the petitioner here, do violence to the legislative intent that where a loss is sustained by a corporate taxpayer and is not compensated for, the same is deductible.

In each instance the transaction by which the Metropolitan Edison Company absorbed its affiliated companies resulted in a purely technical change in the relation between it and those companies. The change was a pure formality involving no change in substance. / No price was paid to the absorbed companies which could or did reflect an allowance for the unamortized bond discount and expense. The absorbed companies never sustained and never took any loss on account of the unamortized bond discount and expense since such loss could only rise when the bonds were retired prior to maturity by the Metropolitan Edison Company. Unless it is entitled to take the loss, no one obtained the benefit thereof contrary to the express intention of Congress that a corporation which sustains a loss which has not been compensated for shall be entitled to deduct the same in computing its net taxable income.

In support of its contention the respondent urges upon this Court the rationale of the decisions in the case of *Western Maryland Rwy. Co.* v. *Commissioner,* 33 F. (2d) 695 (C. C. A. 4) and *New York Cent. R. Co.* v. *Commissioner,* 79 F. (2d) 247 (C. C. A. 2).

In *Western Maryland Railway Co.* v. *Commissioner*, 33 Fed. (2d) 695 (C. C. A. 4), the question was whether the Western Maryland Railway Co. was entitled to amortize and deduct discount on bonds issued by its predecessor which consolidated with seven subsidiaries, all of whose stock it owned and whose property it operated as its own. The Interstate Commerce Commission required that the unamortized discount be carried on the balance sheet of the consolidating company and amortized over the remaining life of the bonds. The Board of Tax Appeals denied the deduction and the Railway Company appealed.

In reversing the decision of the Board the Court said:

> "We come then to the second question in the case: Has the right to deduct the amortized portion of the discount been lost by reason of the reorganization of the corporation that sold the bonds and the taking over of its assets and liabilities by the consolidated company? We think not. In the first place, it is perfectly clear that, although there has been a reorganization and although the consolidated corporation is a distinct legal entity from those whose places it has taken, nevertheless in all of its essential relationships, it occupies exactly the same position which they occupied. Its management is the same, its assets are the same, its stockholders are the same, and its obligations are the same, except that the floating indebtedness of the old corporation has been taken up by the first preferred stock of the new, a change which might have been effected by the

old corporation without reorganization, and which manifestly can have no bearing upon the matter of bond discount. In other words, the consolidated corporation has stepped into the place of the corporation which issued the bonds, and occupies the same relationship towards them that it occupied. It has received no consideration for its agreement to pay them except the assets of the old corporation which have been transferred to it. It has the same property as the old corporation, owes the same bonded debt, and is bound to pay it in the same way. The Interstate Commerce Commission requires that the unextinguished discount be carried on the balance sheet of the company and that same be amortized by charge against income for the remaining life of the bonds, just as though no reorganization had taken place; and, if the deduction is to be allowed as a basis for rate making and for determining the rights of the government under the recapture clause of the Transportation Act, there is no reason why it should not be allowed in determining the basis of taxation also. *After all, while there is a technical legal difference between the old and the new corporations, they are the same as a practical matter, both holding the same property and representing the same ownership, and it is a settled principle that 'courts will not permit themselves to be blinded or deceived by mere forms of law but, regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require.'* Chicago, Milwaukee & St. Paul R. Co. *v.* Minneapolis Civic Assn., 247 U. S.

490, 501, 38 S. Ct. 553, 557 (62 L. Ed. 1229); Southern Pac. Co. *v.* Lowe, 247 U. S. 330, 38 S. Ct. 540, 62 L. Ed. 1142; Gulf Oil Corporation *v.* Lewellyn, 248 U. S. 71, 39 S. Ct. 35, 63 L. Ed. 133. *"The rule just stated is of peculiar importance in tax cases; for, unless the courts are very careful to regard substance and not form in matters of taxation, there is grave danger on the one hand that the provisions of the tax laws will be evaded through technicalities and on the other that they will work unreasonable and unnecessary hardship on the taxpayer.* It is instructive to note the many tax cases decided in recent years in which the courts have not hesitated to ignore corporate forms, and to decide the questions involved in the light of what the parties have actually done, rather than on the basis of the forms in which they have clothed their transactions. See Weiss *v.* Stearn, 265 U. S. 242, 44 S. Ct. 490, 68 L. Ed. 1001, 33 A. L. R. 520; U. S. *v.* Phellis, 257 U. S. 156, 42 S. Ct. 63, 66 L. Ed. 180; Eisner *v.* Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570; Gulf Oil Corp. *v.* Lewellyn, *supra;* Alpha Portland Cement Co. *v.* U. S. (C. C. A. 3d), 261 F. 339; Appeals of A. J. Siegel, 4 B. T. A. 186; Appeal of H. E. Brubaker, 4 B. T. A. 1171. *We think, therefore, that as the new corporation, while technically a distinct legal entity, is to all practical intents and purposes a mere continuation of the old, it is entitled to the same deduction on account of amortized bond discount that the old corporation would have been entitled to, if the reorganization had not taken place."* (Italics added.)

It is important to note from the above statement that, although there was a technical legal consolidation in that case, the Court did not base its opinion upon that fact, but upon the fact that the consolidation effected a change in form only and that although the consolidating corporation was technically a different corporation from the issuing corporation, it was "to all practical intents and purposes a mere continuance of the old" and "entitled to the same deduction on account of bond discount that the old corporation would have been entitled to." Indeed the Court continued:

> "In the second place, we think that, irrespective of the practical identity of the old and new corporations, petitioner is entitled to the deductions claimed because of having taken over the assets and assumed the liabilities of the old corporation which was unquestionably entitled to it. Among the liabilities of the old corporation as shown by its books was the bond issue; and among its assets was the amount set up as bond discount, against which was charged each year an amortized portion thereof. In taking over the liabilities and assets, the new corporation took the place of the old as to both of these items. As has been said, bond discount is really deferred interest payable at the maturity of the bonds. When, therefore, the new corporation assumed the obligations of the old, its agreement to pay the bonds at maturity embraced necessarily the agreement to pay this deferred interest, which is included in the face of the bonds. As the

new corporation is bound to pay this, there is no reason why it should not amortize it in the same way as the old corporation."

The decision of the Court in the Western Maryland case was approved by the Circuit Court of Appeals for the Second Circuit in *New York Central Railroad Co.* v. *Commissioner,* 79 Fed. (2d) 247, in which the Court said:

"In Western Maryland R. Co. *v.* Commissioner, 33 F. (2d) 695 (C. C. A. 4), it was held that a consolidated corporation steps into the place of the constituent corporations and is entitled to deduct amortized discount on bonds issued by them. We think this decision is sound and should be followed in the case at bar. The consolidated corporation does not succeed to the rights and liabilities of the constituent companies as a purchaser but as a successor by operation of law. See Cortland Specialty Co. *v.* Commissioner, 60 F. (2d) 937, 939 (C. C. A. 2); Commissioner *v.* Oswego Falls Corp., 71 F. (2d) 673, 676 (C. C. A. 2). The assets of the consolidated corporation have the same cost basis as they had when held by the old companies and are subject to the lien of the bond issues. Hence the consolidated corporation will suffer a loss when it pays the bonds at par, and the regulations as to spreading this loss over the life of the bonds should apply. They do not in terms confine discount deductions to the issuing corporation, and should not be construed to do so. If the new corporation cannot take the deduction, no one can, for the old companies sustained no loss

when the consolidation was affected. As already stated, the subject of amortization is the difference between the cash realized on the bonds and their par value. This difference the consolidated corporation will pay when the bonds mature, and this expenditure it should be allowed to anticipate by yearly amortization during the life of the bonds in order more clearly to reflect its income.

"* * * * * * *

"The petitioner also claims to be entitled to deduct in each of the taxable years the amount of $29,518.97 discount on bonds of predecessor companies which were merged with the petitioner. The principles above discussed as applicable in case of consolidation are equally applicable to merger. * * *." (Page 250 of opinion.)

Petitioner takes the position that the Metropolitan Edison Company, in assuming the bonds of its affiliates, agreed to pay the full face value of the bonds in consideration of the assets being transferred to it, and that, for this reason, the company received full consideration for its promise to pay the bonds and has suffered no discount.

This argument was effectively answered by the Circuit Court of Appeals for the Fourth Circuit in *Western Maryland Railway Co.* v. *Commissioner,* 33 F. (2d) 695, where the Court said at page 698:

"It is argued, however, that the new corporation has agreed to pay the full face of the bonds in consideration of the assets transferred to it.

and that, for this reason, it has received full consideration for them and has suffered no discount. But this by no means follows. The fact that bonds have been sold at a discount presupposes that the interest rate which they carry is less than the prevailing rate at the time of sale; and it is but fair to assume that this has been taken into account in the price paid or the terms agreed upon for the transfer of the corporate assets. The matter takes care of itself in the case of a reorganization such as this; for it is manifest that, as the discount was mirrored in the affairs of the old corporation by the fact that its actual assets were that much less than they would have been had the discount not been enacted, it is mirrored in exactly the same way when the assets pass into the hands of the reorganization. As a man cannot lift himself by his own bootstraps, so a corporation cannot, by a mere process of reorganization, increase its actual assets or wipe out the fact that it is bound to pay bond discount which is in reality deferred interest."

The petitioner takes the same position in this case as he did in the case of *New York Central R. Co.* v. *Commissioner*, 73 F. (2d) 247, to the effect that deductions for losses, being personal to the taxpayer who actually sustained them, only the corporation actually issuing the bonds may deduct unamortized debt discount and expense. This contention was rejected and effectively answered by the court in the *New York Central R. Co.* case, *supra*, in its opinion on page 249 of the Reports, as follows:

"The Commissioner argues that allowable deductions are personal to the taxpayer and cannot be transferred to or used by another. But the cases which announce this doctrine deal with losses sustained by a predecessor and sought to be deducted by a successor. New Colonial Ice Co. *v.* Helvering, 292 U. S. 435, 54 S. Ct. 788, 78 L. Ed. 1348; Brandon Corp. *v.* Commissioner, 71 F. (2d) 762 (C. C. A. 4); May Oil Burner Corp. *v.* Commissioner, 71 F. (2d) 644 (C. C. A. 4); Cem Securities Corp. *v.* Commissioner, 72 F. (2d) 295 (C. C. A. 4); Athol Mfg. Co. *v.* Commissioner, 54 F. (2d) 230 (C. C. A. 1). In the case at bar, no loss was sustained by the issuing corporations in selling their bonds at a discount; the loss will be sustained by the consolidated corporation when the bonds mature and are paid. Hence the deductions here in question are by way of anticipation of the taxpayer's own loss and should have been allowed."

The Circuit Court of Appeals, in the case of *General Gas & Elec. Corp., supra,* in sustaining the position of the petitioner based its decision upon the theory that the deduction for unamortized debt discount and expense on bonds of a predecessor company may be allowed only where the predecessor company was technically merged into the company actually sustaining the loss through payment of the bonds prior to maturity. This argument was apparently based upon the prior decision of the Second Circuit Court of Appeals in *American Gas & Electric Company* v. *Commissioner,* 85 Fed. (2d)

527. We respectfully submit that the decision of the majority of the Court in the *American Gas* case was erroneous and that the correct principle was laid down in the dissenting opinion of Judge Learned Hand. In that opinion, Judge Hand states:

> "If a company keeps its books on an accrual basis and issues bonds at less than par, the discount is immediately incurred, whether one regards it as a loss or an expense. If the books are on a cash basis, the discount is not paid until the bonds are paid. Thus, in either case there is no legal warrant for spreading the deduction over the life of the bonds; the practice which has grown up and is of undoubted validity, is based upon a fiction, following the accountant's device for preparing to meet the burden of paying the discount all at once. Unless this fiction is extended to cover a buyer in 'reorganization' it will be the means of preventing the deduction of a part of what at some time or other is an undoubted loss or expense. The buyer is not a party to the original loan and cannot claim any deduction because of it; it merely buys the assets and pays for them in cash and by a promise to pay the face of the bonds. It is true that that promise includes the discount, but the cash payment presumably is less by that amount, if the bonds bear interest. Certainly the buyer has not suffered any loss, or paid any expense. Nor will any deduction because of it appear in estimating the buyer's gain or loss, if it sells the assets in whole or in part. True, the buyer's 'basis' is the seller's 'basis,' but if the seller had sold the assets, its 'basis' would not include the discount.

> It would be the cost of the assets sold; that is, the amount borrowed so far as the proceeds of the bonds had been used to buy them. Therefore, all deduction for the unamortized discount disappears from the computation of the taxes of either buyer or seller, unless the buyer is allowed to complete the amortization deductions. A legal fiction is a good contrivance only if it effects a just result, but there is no excuse for it otherwise; this one must be carried out consistently in order to avoid injustice. There may be difficulties when the books are kept on a cash basis, but when as here they are not, it seems to me that the deductions of which the seller is deprived should enure to the buyer rather than be denied in toto."

We further submit that any rule which recognizes the fiction of amortization, and yet refuses to extend the fiction to its logical result, but rather restricts it in such a way as to deprive a taxpayer of a valid deduction for an actual loss, is based upon the technicalities of form, and neglects the fundamental reasoning expressed in the foregoing dissenting opinion, and also in the opinion of the Circuit Court of Appeals for the Fourth Circuit in the *Western Maryland Railway Company case, supra,* as well as in the opinion of the Circuit Court of Appeals for the Second Circuit itself, in the *New York Central Railway Company case, supra.* The true principle, we believe, should be based upon a judicial recognition of the fact that the payment of the unamortized discount is actually made, and the loss is actually sustained, by the successor

company in all cases where the transfer does not involve an arms-length sale for an independent consideration. If this principle be recognized, the proper rule of law would be that unamortized debt discount and expense, representing either additional interest or loss, should always be allowed to the corporation which actually pays it, except in cases where the circumstances show a reasonable probability that the amount of the additional interest or loss has already been compensated for in one form or another. This rule was clearly recognized by the Court of Claims in *American Gas & Electric Company* v. *United States* (17 F. Sup. 151), wherein it stated:

> "* * * The Securities Corporation acquired the assets of the Virginia Company by the payment of a definite consideration, and we think it is a fair presumption that the price so paid was adjusted to meet the fact that the corporation would have to pay the bonds in full."

In the instant case this situation does not obtain for the reason that no price was paid to make adjustment for the fact that the Metropolitan Edison Company would have to pay the bonds in full. Since there was no purchase price paid by way of consideration for the transfers here involved, it cannot be said that they constituted "sales" as distinguished from "mergers." The Metropolitan Edison Company merely surrendered the stock which it owned in the subsidiary companies in exchange for the assets of those companies. Under the circumstances in this

case no consideration was fixed in relation to the assets transferred nor was there taken into account the additional interest or loss represented by the unamortized discount and expense on the bonds of the constituent companies.

If in this case consideration had been paid, as in the case of an ordinary sale between corporations, the price so paid for the assets would have been diminished so as to reflect the amount of unamortized bond discount and expense, a purely fictitious asset or balancing item on the seller's balance sheet. In such case the loss would have been already "compensated for" within the meaning of the Revenue Acts, and, therefore, would not be deductible. Here, however, as has been pointed out, the contrary situation is evident.

Therefore, since it is impossible in the present case to infer that the price paid for the assets received by the Metropolitan Edison Company was adjusted to meet the fact that the company would have to pay the bonds in full, there are no circumstances which require or permit the disallowance of a deduction for additional interest or loss actually paid or sustained by that company, and for which it received no compensation.

It cannot be said either that by claiming the deductions the Metropolitan Edison Company is carrying over a loss sustained by a predecessor corporation such as in the case of *The Pennsylvania Company, etc.* v. *Commissioner,* 75 F. (2d) 719, and similar cases, or that the company is claiming a deduction

for a loss which has already been compensated for by being reflected in the purchase price of the assets of the old companies, as in *American Gas & Elec. Co. v. Commissioner,* 85 F. (2d) 527.

In a foot note to page 47 of his brief, the petitioner calls attention to the fact that the Board of Tax Appeals allowed the Metropolitan Edison Company to deduct the premium paid upon the bonds at maturity, upon the ground that that was an expense incurred for its own benefit (R. 37-39). The petitioner contends, however, that the same reasoning does not apply to the unamortized bond discount and expense. It is submitted on behalf of the respondent that there is no logical reason for making a distinction between a loss on account of preimums paid at the time that bonds are redeemed prior to maturity and a loss for unamortized bond discount and expense remaining at the time the bonds are redeemed in a case such as this where both the premium and the unamortized bond discount and expense represent an actual loss to the taxpayer for which it has not been compensated.

In presenting the argument that the Metropolitan Edison Company is not entitled to deduct the loss sustained on account of unamortized bond discount and expense, the petitioner states on page 38 of his brief that:

> "The regulations do not provide that a successor corporation shall be permitted to deduct amortization of bond discount and expense with respect to bonds issued by its predecessor. See

Article 68 of Regulations 74 (Appendix A, *infra*, p. 58). They grant the deduction in terms only to the corporation issuing the bonds."

It is submitted that Article 68 (3) (b) of Regulations 74 (Appendix A, *infra*, p. 70), does not limit the deduction for unamortized bond discount and expense to the corporation issuing the bonds. If, however, the Regulations are to be so interpreted and construed then they are not in accordance with the provisions of the Revenue Acts of 1926 and 1928 which, as have been pointed out, allow a corporation to deduct a loss which it has actually sustained and for which it has not been compensated.

CONCLUSION.

Since the transactions by which the Metropolitan Edison Company took over the assets and assumed the liabilities of Cumberland Valley Light & Power Company, the York Haven Water & Power Company, the Hanover Power Company, the Pennsylvania Edison Company and the Metropolitan Power Company were, under Pennsylvania law, either statutory or *de facto* mergers, the Respondent was entitled to the deductions claimed on account of unamortized bond discount and expense.

In any event the deductions should be allowed since the Revenue Acts of 1926 and 1928 specifically provide that corporations in computing their net income

may deduct losses for which they have not been compensated. No loss was sustained in this case by anyone either directly or indirectly on account of the unamortized bond discount and expense until the bonds were redeemed prior to maturity by the Metropolitan Edison Company, which then sustained the loss by reason of the fact that the corporations issuing the bonds had merged into the Metropolitan Edison Company which became the successor to all of their assets and liabilities. To deny the loss to the taxpayer in this case defeats the legislative intent.

It is therefore contended that the decision of the Court below should be affirmed.

Respectfully submitted,

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FEBRUARY, 1939.

APPENDIX A.

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 234. (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title;

* * * * * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise."

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. *Deductions from Gross Income.*—In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a

reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

Treasury Regulations 74:

"ART. 68. *Sale and retirement by corporation of its bonds.*—(1) (*a*) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchasing price over the issuing price or face value is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires

any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(2) (*a*) If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income) over the purchase price is gain or income for the taxable year.

(3) (*a*) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of dis-

count already deducted, the excess of the purcha price over the issuing price plus any amount of di count already deducted (or over the face value minu any amount of discount not yet deducted) is a d ductible expense for the taxable year. (*c*) If, ho ever, the corporation purchases and retires any such bonds at a price less than the issuing price pl any amount of discount already deducted, the exce of the issuing price plus any amount of discou already deducted (or of the face value minus a amount of discount not yet deducted) over the pu chase price is gain or income for the taxable year.

ART. 176. *Sale of capital stock, bonds, and capit assets.*—A corporation sustains no deductible loss fro the sale of its capital stock. (See article 66.) If sells its bonds at a discount, the amount of su discount is treated in the same way as interest pa and if it retires its bonds at a price in excess of t issuing price, such excess may usually be deducted expense. (See article 68.) Any loss sustained by corporation upon the sale of its capital assets, co puted as provided in sections 111-113 and articles 5 604, subject to the limitation provided in section 1 as to the purchase and sale of stock or securities, deductible."

Treasury Regulations 69:

[Inasmuch as Articles 545 and 563 of thes Reg lations are identical in all material respects wi Articles 68 and 176 of Regulation 74 above quote they are not set forth separately.]

APPENDIX B.

Section 23 of the Pennsylvania General Corporation Act of 1874, as amended.

(Purdon's Penna. Statutes, Annotated (Permanent Ed.), Title 15, Section 595.)

"SEC. 595. *Reduction of capital stock; change in value of shares; conveyance of franchise and property.*—Any corporation created under the provisions of this act, and any corporation of the classes named in the second section thereof, that is now in existence by virtue of any law of this Commonwealth, may reduce its capital stock or alter and change the par value of the shares thereof, by a vote of the stockholders taken in the manner and under the regulations prescribed in the eighteenth, nineteenth, twentieth, twenty-first, and twenty-second sections of this act; and it shall be lawful for any corporation in the same manner to sell, assign, dispose of, and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal, and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid: *Provided,* That the returns required by said section shall not be filed in the office of the Secretary of the Commonwealth until each and every corporation, so selling, assigning, disposing, and conveying such franchises and property, shall have filed with the Secretary of the Com-

monwealth, a certificate from the Auditor Gener of the Commonwealth, setting forth that all repor required by the Auditor General of the Commo wealth have been duly filed to the date of the propose sale, assignment, disposition, and conveyance; an that all taxes due the Commonwealth of Pennsylvani have been paid up to and including such date. * * (1874, April 29, P. L. 73, Sec. 23; 1876, April 1 P. L. 30, Sec. 5; 1915, June 2, P. L. 724, Sec. 1 1931, June 12, P. L. 561, Sec. 1)."

Purdon's Pennsylvania Statutes, Annotated (Per manent Edition), Title 15 (Act of 1909):

"SEC. 421. *Merger authorized; exceptions; exclusiv franchise not extended; merger subject to act o 1907.*—It shall be lawful for any corporation, now or hereafter organized under the provisions of any general or special act of Assembly authorizing the formation of any corporation or corporations, to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation into which such merger shall be made: * * *

SEC. 422. *Procedure; joint agreement; approval by stockholders; certificates; approval by governor.*—

Said merger or consolidation shall be made under the conditions, provisions, and restrictions, and with the powers, herein set forth; to wit,—

First.—The directors of each corporation shall enter into a joint agreement, under the corporate seal of each corporation, for the merger and consolidation of said corporations; prescribing the terms and conditions thereof, the mode of carrying the same into effect, the name of the new corporation, the number and names of the directors and other officers thereof, name adopted in and by said agreement possessing all the rights, privileges, and franchises theretofore vested in each of them; and all the estate and property, real and personal, and rights of action, of each of said corporations, shall be deemed and taken to be transferred to and vested in the said new corporation, without any further act or deed: Provided, That all rights of creditors and all liens upon the property of each of said corporations shall continue unimpaired, limited in lien to the property affected by such liens at the time of the creation of the same, and the respective constituent corporations may be deemed to be in existence to preserve the same; and all debts not of record, duties, and liabilities of each of said constituent corporations shall thenceforth attach to the said new corporation, and may be enforced against it to the same extent and by the same process as if said debts, duties, and liabilities had been contracted by it. * * *"

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1938.

No. 487.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

PENNSYLVANIA WATER & POWER COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR RESPONDENT.

EDWIN M. STURTEVANT,
CLYDE T. WARREN,
Attorneys for Respondent.

The Daily Record Co. Print, Baltimore.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF FOR RESPONDENT.

OPINIONS BELOW.

The opinion of the United States Board of Tax Appeals (R. 16-25) in this case is reported in 36 B. T. A. 467, and the opinion of the Circuit Court of Appeals (R. 45-47), in 98 Fed. (2d) 812.

Cases now before this Court involving substantially the same question are *Metropolitan Edison Company v. Con-*

missioner of Internal Revenue, 35 B. T. A. 1110, 98 Fed. (2d) 807, and *General Gas and Electric Corporation v. Commissioner of Internal Revenue*, 36 B. T. A. 1326, 98 Fed. (2d) 561.

QUESTION PRESENTED.

Respondent, as successor to its wholly owned subsidiary, in making its income tax return for the year 1928, deducted as an expense the unamortized discount and expense applicable to bonds issued by the subsidiary and retired in that year by Respondent. In the prior year the subsidiary had transferred all its property and franchises to Respondent under the procedure prescribed by the Act of the Commonwealth of Pennsylvania of April 29, 1874, Section 23, as amended, commonly known as the "short form" Merger Act. The question presented is whether this transaction was a mere sale, as Petitioner asserts, or a merger, or a change in form only equivalent to a merger, as Respondent contends.

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved will be found in Appendices A-E, *infra*, pp. 57-73.

STATEMENT OF CASE.

Respondent operates a hydro-electric power plant on the Susquehanna River at Holtwood, Pennsylvania (R. 28). In order to provide its customers with an adequate and continuous supply of electricity and to utilize varying river flow to the best advantage, it became necessary to provide an auxiliary power plant operated by steam (R. 29). Respondent, being advised by its counsel that it had no corporate powers to engage in the business of generating electricity by steam, caused Holtwood Power Company, hereinafter referred to as "Holtwood Company", to be incorporated to carry on this activity (R. 29).

Respondent at all times owned all the capital stock of the Holtwood Company (R. 29) and operated the steam plant as a department of its business at such times as conditions of river flow necessitated the utilization of an auxiliary supply of electric energy (R. 30). The steam plant was operated by Respondent under an agreement dated August 26, 1924 (R. 34-36) by which Respondent received the entire output of the steam plant and paid all expenses of Holtwood Company, including an amount "to provide for amortization of debt, discount and security issue expense".

After the incorporation of Holtwood Company, Respondent was advised by its counsel that the two companies could not consolidate or merge because Respondent had the power to supply water to the public, which power Holtwood Company did not possess (R. 31). On June 26, 1926, the Supreme Court of Pennsylvania, in the case of *York Haven Water & Power Company et al. v. Public Service Commission of Pennsylvania et al.*, 287 Pa. 241, 134 Atl. 419, decided, under similar facts, that such a merger or consolidation might be consummated, provided the power to supply water be legally discarded (R. 31).

Respondent, on October 4, 1927, surrendered its corporate power to store, transport and supply water, in the manner prescribed by the corporation law of Pennsylvania (R. 31).

On December 21, 1927, Holtwood Company transferred all its property and franchises to Respondent under the procedure prescribed by the Act of the Commonwealth of Pennsylvania of April 29, 1874, Section 23, as amended by the Act of April 17, 1876, Section 5 and the Act of June 2, 1915 (R. 31). The sole consideration for the transfer

was the surrender of Holtwood's capital stock to it and the assumption of the obligation of its outstanding bonds by Respondent (R. 31). As provided in the Act, Holtwood Company "ceased to exist", upon the consummation of the transaction. [The Act of 1874 with its amendments, Purdon's Pennsylvania Statutes annotated, Title 15, Secs. 262-266, 595 (the applicable sections of which are set out in Appendix B hereof) will hereinafter be referred to as the "Act of April 29, 1874, as amended."]

Holtwood Company had issued its 6% bonds at a discount of five points in order to provide part of the funds for constructing the steam plant (R. 30), which discount and the expense incident to issuing the bonds was being amortized for income tax purposes over the life of the bonds (R. 30-31). Holtwood Company, prior to the transfer of its property and franchises, had no income other than payments made by Respondent pursuant to the agreement dated August 26, 1924 (R. 34-36), which included an annual payment to cover the amortization of debt discount and expense. Each year from 1924 to 1927, inclusive, a consolidated income tax return was filed for Respondent and the Holtwood Company in which the amortization of debt discount and expense was accounted for as follows: Respondent deducted the payments on account of amortization of debt discount and expense from its gross income as ordinary and necessary business expenses (cost of power), and the Holtwood Company reported these payments as income, which were offset by its deductions on account of amortization of discount and expense (R. 30-31). As the bonds were still outstanding when the transaction above referred to was effected, a part of the discount and expense remained unamortized (R. 32).

On March 1, 1928, Respondent retired the Holtwood bonds before maturity at a premium of 7% pursuant to the provisions of the mortgage indenture securing the bonds (R. 32), the necessary funds being secured from the sale of Respondent's 4½% bonds (R. 20). In its income tax return for that year, Respondent claimed deductions for the unamortized discount and expense and the retirement premium (R. 32).

Petitioner disallowed the deductions (R. 10), and Respondent appealed to the Board of Tax Appeals, which, by its decision, allowed the deduction of the premium but denied the deduction of the unamortized discount and expense on the ground that the transaction was not a merger but simply a sale of Holtwood Company's property to Respondent. Respondent appealed to the Circuit Court of Appeals for the Third Circuit, which, by its decision, reversed the decision of the Board of Tax Appeals and allowed the deduction of unamortized discount and expense on the ground that the transaction was a merger.

SUMMARY OF ARGUMENT.

Respondent relies upon the following propositions:

I. It is well established by the decisions of the courts and by regulations of the Treasury Department, promulgated in conformity therewith, that when bonds issued at a discount are retired for cash prior to maturity by the issuer, the entire amount of unamortized discount and expense is deductible for income tax purposes in the year of the retirement even though the funds for such retirement are derived from the proceeds of a subsequent bond issue.

II. The Board of Tax Appeals and the courts have uniformly held that a corporation succeeding through

merger or consolidation to the assets and liabilities of the corporation issuing the bonds at a discount is entitled to the same deductions on account of bond discount and expense as the issuer.

III. The transaction by which Respondent succeeded to the assets and liabilities of the Holtwood Company was a merger.

IV. The transaction in question involved a change in form only and therefore the deductions should be allowed irrespective of the technical nature of the transaction.

ARGUMENT.

I.

IT IS WELL ESTABLISHED BY THE DECISIONS OF THE COURTS AND BY REGULATIONS OF THE TREASURY DEPARTMENT PROMULGATED IN CONFORMITY THEREWITH THAT WHEN BONDS ISSUED AT A DISCOUNT ARE RETIRED FOR CASH PRIOR TO MATURITY BY THE ISSUER, THE ENTIRE AMOUNT OF UNAMORTIZED DISCOUNT AND EXPENSE IS DEDUCTIBLE FOR INCOME TAX PURPOSES IN THE YEAR OF THE RETIREMENT EVEN THOUGH THE FUNDS FOR SUCH RETIREMENT ARE DERIVED FROM THE PROCEEDS OF A SUBSEQUENT BOND ISSUE.

When long-term bonds are issued by a corporation they may be sold by it at par or face value, at a discount, or at a premium. The controlling factors in determining whether the bonds shall be sold at par, at a discount, or at a premium are (1) the market rate of interest as compared with the interest rate specified in the bonds, and (2) the time which will elapse before the bonds mature. If the interest rate specified in a long-term bond is less than the market rate, investors are unwilling to pay par for the bonds and they must be sold at a discount. Conversely, if the bond interest rate is more than the market rate, the bonds may be sold at more than par, i. e., at a premium.

If an issue of 6% $1,000 bonds, maturing in 30 years, is sold at 97, the true interest cost of the borrowed money is the 6% interest prescribed in the bonds plus the discount of three points. Because this is the fact it is the accepted practice, for accounting and income tax purposes, to amortize the discount by writing it off in equal installments over the life of the bonds in order that each year may show the accurate or real cost of carrying the bond issue. In the case illustrated the true annual interest on each bond is treated as being $61 or 6.1% of the par value of the bond, $60 being paid to the bondholder and $1 being the amortization write-off (or the annual accrual to enable the issuer to pay the discount at the maturity of the bonds). Both the 6% interest and the .1% amortization write-off are deductible as accrued expense in computing the corporation's annual income tax.

The above theory of the nature of bond discount and the treatment for income tax purposes was explained by the Board of Tax Appeals in *Chicago, Rock Island & Pacific Railway Co. v. Commissioner,* 13 B. T. A. 988, 1031, 1033, quoted with approval by the Circuit Court of Appeals for the Fourth Circuit in *Western Maryland Railway Co. v. Commissioner,* 33 Fed. (2d) 695, 697.

If the bonds are paid off prior to maturity, say at the end of 10 years, at which time discount of $10 per bond has been written off, then the remaining $20 of such discount, which has not been amortized, must be paid by the corporation from its surplus or other funds. This unamortized discount is deductible in its entirety by the corporation in computing its income tax for the year in which the bonds are retired.

U. S. Internal Revenue Regulations No. 74, Art. 68 (3), promulgated under the Revenue Act of 1928. (See Appendix A.)

Expenses incurred by the corporation in issuing the bonds are treated in the same manner as discount for income tax purposes if the books are kept upon the accrual basis. Paragraph 4 of the Statement of Evidence (R. 28) shows that Respondent's books are kept on that basis.

Helvering v. Union Pac. Railroad Co., 293 U. S. 282 (1934).

At times the market rate of interest declines materially so that a corporation can borrow money at a lower rate of interest than that borne by its outstanding bonds. In such case the outstanding bonds may be refunded. The corporation issues new bonds at the lower interest rate and with the cash obtained therefrom retires the old bonds prior to maturity pursuant to an option usually contained in corporate bonds.

Petitioner formerly contended that when bonds were retired prior to maturity by the use of proceeds of a refunding bond issue, the unamortized discount and expense and any retirement premium applicable to the retired bonds were expenses of floating the new issue and should be amortized over the life of the new bonds. The Board of Tax Appeals and the courts uniformly held that in such cases the entire amount of unamortized discount and expense, together with retirement premium, is deductible in the year of the retirement.

The East Ninth Euclid Co. v. Commissioner, 26 B. T. A. 32 (1932) (Rehearing 27 B. T. A. 1289);

San Joaquin Light and Power Corporation v. McLaughlin, 65 Fed. (2d) 677 (1933) (C. C. A. 9);

The National Tile Co. v. Commissioner, 30 B. T. A. 32 (1934);

Helvering v. California-Oregon Power Co., 75 Fed. (2d) 644 (1935) (C. A., D. C.).

Petitioner acquiesced in these decisions and on November 9, 1935 promulgated *Treasury Decision 4603* (Internal Revenue Cumulative Bulletin XIV-2, p. 58) (See Appendix A) notifying the "Collectors of Internal Revenue and Others Concerned" that—

> "In determining the deductions for income tax purposes of items in respect of the refunding of bonds, the following rules shall apply in the instances specified:
>
> "(a) In the case of a retirement of an issue of old bonds from the proceeds of the sale of new bonds any amount paid in excess of the face value of the old bonds, less any amount of premium received when issued and not already returned as income, and any unamortized discount and unamortized expense attributable to such bonds, is deductible in the taxable year of their retirement."

The holding of the above cases and *Treasury Decision 4603* was approved by this Court in *Great Western Power Company of California v. Commissioner of Internal Revenue*, 297 U. S. 543, 546 (1936) (Footnote 7).

Petitioner and Respondent therefore agreed before the Board of Tax Appeals and the Circuit Court of Appeals that in the case at bar the sole question to be determined was whether Respondent, *as successor to the Holtwood Company*, was entitled, in computing its income taxes for 1928, to deduct the unamortized discount and expense applicable to the Holtwood bonds which it retired prior to maturity in that year.

II.

THE BOARD OF TAX APPEALS AND THE COURTS HAVE UNIFORMLY HELD THAT A CORPORATION SUCCEEDING THROUGH MERGER OR CONSOLIDATION TO THE ASSETS AND LIABILITIES OF THE CORPORATION ISSUING THE BONDS AT A DISCOUNT IS ENTITLED TO THE SAME DEDUCTIONS ON ACCOUNT OF BOND DISCOUNT AND EXPENSE AS THE ISSUER.

The question involved in the case at bar, viz., the right of a corporation succeeding to all the assets and liabilities of a predecessor to deduct discount and expense applicable to bonds issued by its predecessor, has been before the Board of Tax Appeals and the courts in the following cases:

Western Maryland Ry. Co. v. Commissioner, 33 Fed. (2d) 695 (1929);
Turner-Farber-Love Co. v. Helvering, 68 Fed. (2d) 416 (1933);
New York Central Railroad Co. v. Commissioner, 79 Fed. (2d) 247 (1935) (Cert. den. 296 U. S. 653);
Illinois Power & Light Corp. v. Commissioner, 33 B. T. A. 1189 (1936) (Modified, 36 B. T. A. 385);
Coast Counties Gas & Electric Co. v. Commissioner, 33 B. T. A. 1199 (1936);
American Gas & Electric Co. v. Commissioner, 85 Fed. (2d) 527 (1936);
American Gas & Electric Co. v. United States, 17 Fed. Sup. 151, 84 Ct. Cl. 92 (1936);
The Connecticut Electric Service Co. v. Commissioner, 35 B. T. A. 444 (1937).

The successor corporation was allowed to take deductions on account of amortization of bond discount and expense (or the unamortized discount and expense where the bonds were retired prior to maturity by the successor) in the *Western Maryland* case, the *New York Central* case,

the *Illinois Power & Light Corp.* case, and *The Connecticut Electric Service Co.* case, in all of which the taxpayer succeeded the issuing corporation through merger or consolidation. In the two *American Gas & Electric Co.* cases, the deductions were allowed where the issuing company was *merged* into the successor and disallowed where the issuing company *sold* its assets to the successor. In the other cases there was clearly a *sale* of assets and the deductions were disallowed.

The Court of Claims in denying the deduction in the *American Gas & Electric Co.* case on the ground that neither a merger nor consolidation had taken place said:

> "• • • the Securities Corporation acquired the assets of the Virginian Company by the payment of a definite consideration, and we think it is a fair presumption that the price so paid was adjusted to meet the fact that the corporation would have to pay the bonds in full."

That being so it would have been inequitable to permit the buying corporation to claim a deduction in its income tax return for the bond discount when an allowance had been made for it in the purchase price.

Respondent desires to point out that as there was no cash or anything of value paid by it to Holtwood Company, the consideration (the surrender of Holtwood Company's stock to it and the assumption of its liabilities) could not have been adjusted, i. e., reduced, because of the unamortized bond discount and expense.

Petitioner conceded before the Board of Tax Appeals and the Circuit Court of Appeals that if the transaction by which Respondent succeeded to the assets and liabilities of the Holtwood Company was in fact a "merger",

the deduction should be allowed, but Petitioner contended that the transaction was in effect a mere sale by Holtwood of its assets.

III.

THE TRANSACTION BY WHICH RESPONDENT SUCCEEDED TO THE ASSETS AND LIABILITIES OF THE HOLTWOOD COMPANY WAS A MERGER.

A. Consolidation, Merger and Sale Distinguished.

The one question in this case primarily involves the distinction between the concepts of *consolidation* and *merger*, on the one hand, and the concept of *sale* on the other. While the terms "consolidation," "merger," and "sale" have distinct and mutually exclusive meanings, legislatures in drafting statutes and courts in their opinions have not always observed the distinctions between them, with the result that the language of statutes and many court decisions tends to confusion unless the statutes and the decisions be carefully analyzed in view of technical definitions of the terms.

A "*consolidation*" is a combination of two or more corporations by which the property, rights, privileges and franchises of all the consolidating corporations are united in a single *new* corporation, the consolidating corporations losing their separate corporate identities.

15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Sec. 7041, pages 6-8.

A "*merger*," while in substance a consolidation, differs therefrom in that it is the absorption of one or more corporations by another, the former ceasing to exist and the latter retaining its corporate identity with the added capital, franchises and powers of the merged corporation or corporations. "It is the uniting of two or more corpora-

tions by the transfer of property to one of them, which continues in existence, the others being merged therein."

15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Sec. 7041, pages 7-8.

A "*sale*" is the transfer of property for a valuable consideration. "Where there is a mere sale or transfer of the assets to another corporation a new corporation is not created and the respective companies remain distinct legal entities."

15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Sec. 7044, page 16.

The criterion between a consolidation or merger on one hand and a sale on the other is that in the former there is an amalgamation of interests, whereas in the latter there is a divorcement of the property from its owners for a fair consideration, the selling corporation not being merged with the corporation acquiring its property but remaining in existence with the power to resume business. As stated in *Cortland Specialty Co. et al. v. Commissioner of Internal Revenue*, 60 Fed. (2d) 937 (1932) (Cert. den., 288 U. S. 599):

> "• • • merger and consolidation are words indicating corporate readjustments of existing interests. They all differ fundamentally from a sale where the vendor corporation parts with its interest for cash and receives nothing more. • • • *A merger ordinarily is an absorption by one corporation of the properties and franchises of another whose stock it has acquired. The merged corporation ceases to exist and the merging corporation alone survives.* A consolidation involves a dissolution of the companies consolidating and a transfer of corporate assets and franchises to a new company. • • • *A sale of the assets of one corporation to another for cash without*

the retention of any interest by the seller in the purchaser is quite outside the objects of merger and consolidation statutes.'' (Italics added.)

B. The Act of April 29, 1874, as Amended, Provides for Merger.

Petitioner contended before the Board of Tax Appeals and in the Circuit Court of Appeals that in Pennsylvania a "merger" must be effected under the Act of May 3, 1909, and that the Act of April 29, 1874, as amended, only defines the procedure for a "sale".

The Act of May 3, 1909 (the pertinent provisions of which are set out in Appendix C), although employing the terms "merger and consolidation", does not provide for a *merger* at all and only provides for a *consolidation*. This is apparent from the provisions of the Act. It provides that a joint agreement shall be entered into, setting forth the "name of the *new* corporation," • • • "the *first* directors and officers," • • • "the manner of *converting the capital stock of each of said corporations into the stock of the new corporation,*" and that "new letters patent" shall be issued thereon. It is clear, therefore, that, although the Act of 1909 uses the terms "merger and consolidation," it effects a combination of two or more corporations into a single *new corporation* for which new letters patent must be issued and the stock of which must be substituted for the stock of the old corporations. Since the Act provides for a *new corporation* in place of all the old corporations combining thereunder and does not provide for the *survival of one of the old corporations* with the added franchises, powers and property of the others, it is obvious that this is a *consolidation* statute and not a *merger* statute.

This fact was pointed out by E. Russell Shockley, Esq., Special Deputy Attorney General and draftsman of the Pennsylvania Corporation Act of 1933, in an annotation to Section 901, which appears on page 104 of *"Pennsylvania Corporation Laws of 1933"*:

> "As used in the Act of 1909, the words 'consolidate' and 'merge' were used synonymously, whereas such words, technically, have different meanings. In a merger, only one of the constituent corporations survives, whereas the others lose their identities; while in a consolidation all the constituent corporations lose their identities and a new corporation springs up in their place. This act, [referring to the 1933 Act] like the Uniform Act and the acts of the states above listed, makes a clear distinction between a merger and a consolidation."

The Act of April 29, 1874, as amended, definitely provides a procedure by which the property, rights and franchises of one corporation may be united with those of another, the latter continuing its existence while the former by operation of the statute *ceases to exist*. The pertinent provisions thereof are as follows:

> *"Section 23.* Any corporation created under the provisions of this act, and any corporation of the classes named in the second section hereof, that is now in existence by virtue of any law of this Commonwealth, may reduce its capital stock or alter and change the par value of the shares thereof, by a vote of the stockholders taken in the manner and under the regulations prescribed in the eighteenth, nineteenth, twentieth, twenty-first and twenty-second sections of this act; and *it shall be lawful for any corporation in the same manner to sell, assign, dispose of and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal and mixed, and thereafter such corporation shall cease to exist, and the*

> *said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid:* Provided, That the returns required by said section shall not be filed in the office of the Secretary of the Commonwealth until each and every corporation, so selling, assigning, disposing, and conveying such franchises and property, shall have filed with the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth, setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed sale, assignment, disposition and conveyance; and that all taxes due the Commonwealth of Pennsylvania have been paid up to and including such date." (Italics added.)

A transaction, like that in the case at bar, under this statute meets all the requirements of a *merger* as above defined. See *supra, pp.* 12-13. This fact has long been recognized by the Bar and the Courts of Pennsylvania, and this Act has been even more frequently used to unify corporations than the Act of 1909.

Mr. Shockley, in the last two sentences of his "Comments" on Sec. 311 of the *"Pennsylvania Corporation Laws of 1933,"* page 39, says:

> "• • • This provision of the act provides a statutory procedure for the voluntary sale of the corporate property and assets, excluding its franchises, and makes no change in the existing case law. *It does not, however, authorize or have the effect of a merger similar to that formerly authorized by Section 23 of the Corporation Act of 1874 as amended."* (Italics added.)

The practice of employing the Act of April 29, 1874, as amended, to merge corporations became common as a re-

sult of the decision of the Supreme Court of Pennsylvania in *Bly v. White Deer Mountain Water Co.*, 197 Pa. 80 (1900). The Court held that certain utility corporations could carry on their business only in the town, borough, city or district in which they were located and not in territory adjacent thereto. The practical result of this decision was that it became necessary for some utility companies to form a different corporation in every municipal district where present or future operations might be contemplated. It was, however, uneconomical to construct a separate operating plant in each district for which a charter had been granted so the plan was evolved of unifying the corporations in order that the business could be carried on in substantially the same manner as if the charter of one corporation authorized it to operate in all the districts. The Legislature had prescribed two methods by which such unification might be effected: (1) merger under the Act of April 29, 1874, as amended, or (2) consolidation under the Act of 1909. As the effect of the Act of April 29, 1874, as amended, preserving the identity or existence of one corporation, offered certain obvious advantages over the creation of a *new* corporation under the Act of 1909, the former was largely employed and the two methods came to be distinguished by the respective descriptive, but untechnical, names of the "short form" and "long form" merger.

In *Pennsylvania Utilities Co. v. Public Service Commission*, 69 Pa. Superior Ct. Rep. 612 (1918), Judge Kephart, now Chief Judge of the Supreme Court of Pennsylvania, made the following statement, concerning the necessity of unifying the charters of such utility companies, in which he recognized the fact that a merger resulted under the Act of 1874, as amended (which he called

the "Purchase Act" of 1876, presumably because one of the steps in effecting the merger took the form of a sale):

> "The question presented by this and a number of other appeals now before the court is of considerable importance to utility companies in the Commonwealth. After the decision in the case of Bly v. White Deer Mt. Water Company, 197 Pa. 80, there was a great effort by certain utilities to secure charters for the municipal districts they deemed necessary to their present and future plan of development. These concerns found it impossible, because of the great economic waste, to construct separate operating plants in each of the districts for which charters were secured. The legislature had supplied a way by which the charters might be unified and very much the same result obtained as though a charter for more than one district had been permitted. The Purchase Act of 1876 was largely employed. See Hey v. Springfield Water Co., 207 Pa. 38; Commonwealth v. Lumber City Water Co., 225 Pa. 317; Greensburg Boro. v. Westmoreland Water Co., 240 Pa. 485; and a list of authorities there referred to. *As a legal consequence the purchase act differs but little from the merger act which is used to some extent to consolidate companies.* * * *" (Italics added.)

In *York Haven Water & Power Co. et al. v. Public Service Commission of Pennsylvania et al.*, 287 Pa. 241, 134 Atl. 419 (1926), the question before the Court concerned the right of an electric light, heat and power company to merge with a hydro-electric or water power company. The Court held that the merger could not be accomplished until the right of the hydro-electric company to furnish water to the public (which was not common to both companies) was legally discarded. In the course of the opinion, the Court, per Kephart, J., said:

"There are two forms of consolidation in Pennsylvania, a short and a long form merger. These are accomplished by the Act of 1876, as amended, and the Act of 1909. The Act of 1876, P. L. 33, as amended, provides that such sale may take place if the 'franchises are not inconsistent' with this act. And the merger Act of 1909, P. L. 408, permits consolidation between corporations 'transacting the same or similar lines of business.' * * *

"* * * *

"* * * *A sale or merger, under the Act of 1876, with its amendment, or the Act of 1909, which is practically the same,* cannot take place until the company legally discards the offending power. * * *" (Italics added.)

The Act of 1876 mentioned by the Court is the Act of 1874 as amended by the Act of April 17, 1876, Sec. 5 and the Act of June 2, 1915, under which the transaction in the case at bar was effected.

The Act of 1874, as amended, was the only law of Pennsylvania under which a merger could be effected prior to the enactment of the Pennsylvania Corporation Law of 1933, and it remains the only Act under which a merger of certain public utility corporations can now be effected inasmuch as the 1933 law does not apply to them. Article IX of the new law, entitled "Mergers and Consolidations," with this exception, repealed both the Act of 1874, as amended, and the Act of 1909 and made a clear distinction between mergers and consolidations. If the transaction in the case at bar had taken place under the Corporation Act of 1933, Article IX, the Petitioner would undoubtedly admit the correctness of Respondent's position. It is therefore pertinent to compare the procedure and effect of a merger under the 1933 Act (See Appendix D) with that under the Act of 1874, as amended:

Procedure and Effect of Merger Under Corporation Laws of 1933:	*Procedure and Effect of "Short Form" Merger Under Act of April 29, 1874, as amended, as followed in the Case at Bar:*
1. Directors of each corporation approve plan of merger (Sec. 902 A) and call meeting of Stockholders (Sec. 902 B).	1. Directors of merging corporation authorize the merger and call meeting of stockholders (Sec. 19). Directors of surviving corporation approve merger under general law.
2. Plan of merger submitted to and approved by stockholders of each corporation (Sec. 902 B-C).	2. Plan submitted to stockholders of merging corporation and approved (Sec. 23 and 20-21).
3. (Sec. 903) Each corporation executes Articles of Merger, containing the following: (a) Name of surviving corporation. (b) Total vote of stockholders by which the plan was adopted. (c) Any changes in charter of surviving corporation. (d) Plan of merger.	3. All property, rights and franchises of merging corporation transferred by deed to the surviving corporation (Sec. 23).
4. Advertisement of intent to file Articles of Merger with Department of State (Sec. 904).	4. Advertisement of object of meeting of stockholders (Sec. 19).
5. Articles of Merger filed in Department of State and approved after all taxes have been paid (Sec. 905).	5. Return of "election of the stockholders" (i. e., the vote on the plan) and return of transfer of property filed with the Secretary of the Commonwealth after all t[illegible]s have been paid (Sec. 22-23).
6. Effect of Merger (Sec. 907): (a) All corporations parties to the plan except the surviving corporation cease to exist. (b) All property and franchises vest in the surviving corporation. (c) Claims existing or actions or proceedings pending against the merging corporation may be prosecuted to judgment against either it or the surviving corporation.	6. Effect of Merger: (a) Corporation transferring property ceases to exist; corporation receiving property survives (Sec. 23). (b) All property and franchises vest in surviving corporation (Sec. 23). (c) Claims existing or actions or proceedings pending against the merging corporation may be prosecuted to judgment against either it or the surviving corporation. (*Merwine v. Mt. Pocono Lt. & Imp. Co.*, 304 Pa. 517).

While the procedural steps under the two acts differ, in effecting a merger like the one in the case at bar, they are not essentially different, and the resultant effect is precisely the same—

(a) The corporation which transfers its property and franchises ceases to exist and the corporation acquiring the property and franchises survives;

(b) Claims existing or actions or proceedings pending against the merging corporation may be prosecuted to judgment against either it or the surviving corporation.

C. Petitioner's Contentions.

Notwithstanding the statements by the Supreme Court of Pennsylvania that a merger may be effected under the Act of April 29, 1874, as amended, Petitioner insists (Petitioner's Brief, p. 22) that such is not the case because

(a) The Act "in terms applies to sales and not to mergers and consolidations;"

(b) The Act "does not provide that the purchasing corporation shall assume the debts of the seller."

The early corporation laws of the various states, like that of Pennsylvania, were not drawn with the care as to detail which characterizes the more modern corporation laws, and inexact language was frequently used. In cases involving the transfer of the franchises and property of a corporation to another under such statutes the courts have looked at the nature of the transaction itself, rather than the phraseology of the statute, in determining whether the transaction was a sale or a consolidation or merger.

In *Chicago, Santa Fe and California Rwy. Co. v. Ashling*, 160 Ill. 373, 380, 381, 43 N. E. 373, 375 (1895), the Chicago and St. Louis Railway Co. transferred all its property and franchises by a deed of conveyance to the appellant. The question before the Court was whether this transaction, which was in form a sale, was not in fact a "consolidation." In holding that the transaction was a "consolidation" and that the defendant was liable for the torts of its predecessor from which it purported to "buy" assets, the Court said:

> "• • • It is true, that what was done must be considered in order to determine whether there was a consolidation or not; but we must look to the results accomplished, rather than to the means, steps or procedure by which those results have been attained.
>
> "• • • *There is no magic in words. Merely calling the transaction a purchase and sale would not prevent it from being a consolidation.* It cannot be supposed, from the nature of this transaction, that it was expected that the St. Louis company should continue its active corporate existence after divesting itself of all its property, corporate rights and franchises and stockholders." (Italics added.)

In *Continental Trust Co. v. Toledo, St. L. & K. C. R. Co.*, 82 Fed. 642, 652 (1897), Mr. Chief Justice Taft, then Circuit Judge, considered the effect of an Illinois statute which provided:

> "That all railroad companies now organized, or hereafter to be organized under the laws of this state, which now are or hereafter may be, in possession of and operating in connection with or extension of their own railway lines any other railroad or railroads in this state, or in any other state or states, or owning and operating a railroad which connects

at the boundary line of this state with a railroad in another state, *are hereby authorized and empowered to purchase and hold in fee simple* or otherwise and to use and enjoy, the railway property, corporate rights and franchises of the company or companies owning such other road or roads upon such terms and conditions as may be agreed upon between the directors and approved by the stockholders," etc. (Italics added.)

Concerning the effect of this statute, which is worded in terms of sale, the learned Judge said:

"Although this act uses the word 'purchase,' it plainly contemplates consolidation, and this is the holding in Illinois * * *"

In 8 *Thompson on Corporations,* 3rd Edition, Sec. 6012, page 66, the learned author says:

"* * * In a merger of two or more corporations, one of the merged corporations survives; that is, the merger consists in the uniting of two or more by the transfer of all the property to some one of the existing corporations, which continues its existence, while the others are swallowed up by or merged in the one that exists. And in this respect it differs from a consolidation, wherein * * * all the corporations terminate their existence and become parties to a new one. *The true test as to whether or not there has been a merger, is as to whether the existence of one of the corporations has been preserved and the other has ceased to exist.*" (Italics added.)

In Section 6019 at page 78 the author says:

"* * * But, as already noticed, and as judicially held, consolidation may be effected by the purchase of all the property and franchises of one corporation by another * * *."

In 15 *Fletcher Cyclopedia Corporations* (Permanent Edition), Sec. 7044, pp. 16-17, the author says:

> "• • • if the coming together of two corporations under the authority of law be in fact consolidation • • • it is of no consequence by what name the act is characterized nor is it of any consequence by what steps the result has been effected, *and one of these steps may take the shape of bargain and sale.*" (Italics added.)

Petitioner says that the courts of Pennsylvania have also construed the Act of 1874 as authorizing *sales* (Petitioner's Brief, p. 30), citing:

Koehler v. St. Mary's Brewing Co., 228 Pa. 648;
Ringler v. Atlas Portland Cement Co., 301 Pa. 176;
Carr v. Rochester Tumbler Co., 207 Pa. 392;
Maxler v. Freeport Bank, 275 Pa. 510;
Greensburg Borough v. Westmoreland Water Co., 240 Pa. 481, 485-486;
Buist's Estate, 297 Pa. 537.

Respondent does not contend that every transaction carried out under the Act of April 29, 1874, as amended, is a merger. The Act has been recognized as authorizing both ordinary sales of property and mergers. No one would say, where one corporation, pursuant to the Act, purchases property and franchises of another *for a full cash consideration*, that the purchaser becomes liable for the obligations of the seller by operation of law, or that there is a *merger* of the corporations. In such a case there is no amalgamation of interests, no continuation of the interests of the owners of the selling corporation in the buying corporation as there must be in a merger. In such instances the old corporation and its

owners *divorce* themselves from the business. Examination of the above cases, cited by Petitioner, reveals that they have no application to the situation involved in the case at bar. In *Koehler v. St. Mary's Brewing Co.*, 228 Pa. 648, there was not a *merger* but an *ordinary sale* of property for which the proposed consideration was $250,000, payable in thirty year bonds of the transferee.

With the fact in mind that either a merger or an ordinary sale may be effected under the Act of April 29, 1874, as amended, the inapplicability of other cases cited by Petitioner (*Ringer v. Atlas Portland Cement Co.*, 301 Pa. 176, *Greensburg Borough v. Westmoreland Water Co.*, 240 Pa. 481, and *Maxler v. Freeport Bank*, 275 Pa. 510) is apparent. In all these cases bills for injunction had been filed by dissenting stockholders to restrain the transfer of the company's assets. In these cases the issue was the legality of the transaction irrespective of the question (which was not involved) whether it was a merger or an ordinary sale. Furthermore, in the *Ringler* case and the *Freeport Bank* case the transactions were not under the Act of April 29, 1874, as amended, which fact was specifically pointed out by the court in both cases. In the former the decision rested on the general power of a corporation flowing from ownership of property to dispose of it unless restrained by its charter or by statute, and in the latter the transaction was effected under a statute (Act of May 13, 1876) relating only to banks.

In *Carr v. Rochester Tumbler Co.*, 207 Pa. 392, cited in Petitioner's Brief, p. 30, plaintiff had attended a stockholders' meeting and voted in favor of the sale of the company's assets to National Glass Co. *for cash and*

stock of the latter. Plaintiff then sued for the value of his stock. It does not appear that the transaction was effected under the Act of April 29, 1874, as amended, for it is not mentioned in the opinion. The decision against the plaintiff rested on estoppel by reason of his vote and the nature of the transaction was not involved. Furthermore, relief to dissenting stockholders by payment of the value of their stock is not inconsistent with either merger or consolidation, such relief often being provided by statute.

Petitioner also relies on the case of *Buist's Estate*, 297 Pa. 537 (Petitioner's Brief, p. 30). In that case there was a merger of Philadelphia banking institutions under the National Banking Act. The Supreme Court of Pennsylvania has, both before and after the decision in *Buist's Estate*, indicated that said transactions under the Act of April 29, 1874, as amended, were mergers. Judge Kephart's statement in the opinion in *Buist's Estate* that the operation of the Act effects a sale therefore is nothing more than a recognition that ordinary sales as well as mergers can be accomplished under the Act.

Analysis of the facts in the case at bar reveals the following: (1) Holtwood Company was incorporated in order to comply with the corporation laws of Pennsylvania to carry on an activity necessary to Respondent's business in which the latter had no power to engage (R. 29); (2) Respondent owned all the capital stock of Holtwood Company (R. 29); (3) the steam plant of Holtwood Company was operated by Respondent's officers and employees simply as a department of Respondent (R. 29-30); (4) on December 21, 1927, after it was found that Holtwood Company could lawfully be merged into or consolidated with Respondent, a short form merger was

effected pursuant to the Act of April 29, 1874, as amended, by the transfer of all the property and franchises of Holtwood Company to Respondent and the surrender of all the capital stock of the former (R. 31); (5) pursuant to the provisions of the Act, Holtwood Company ceased to exist as a separate corporate entity (R. 31); (6) the interests of the owners of Holtwood Company and Respondent remained the same after the transaction as before, Respondent simply absorbing Holtwood Company and continuing to exist with the added property and franchises of the latter. The short form merger of Holtwood Company into Respondent therefore meets all the requirements of a true merger.

D. Liability of Successor Corporation for Debts and Torts of Merged Corporation.

The Circuit Court of Appeals for the Second Circuit, in the *General Gas & Electric Corporation* case now before this Court (98 Fed. (2d) 561), said:

> "* * * In American Gas & Elec. Co. v. Commissioner, 85 F. (2d) 527, this court stated as an essential of such a merger as would entitle the successor corporation to claim deductions of the unamortized bond discount and expense of the merged corporation, that the successor must by operation of law become responsible for the liabilities of the merged corporation. A provision imposing such liability is certainly customary in technical merger statutes; such liability is expressly provided in the 'long form merger' Act of 1909, as it is also in the Act of May 5, 1933. The absence of such a provision in the Act of 1874, and the construction placed upon that statute in Merwine v. Mt. Pocono Light & Imp. Co., 304 Pa. 517, seem to us fatal to the taxpayer's contentions. In that case the plaintiff, a creditor of the

> selling corporation, moved to substitute the purchasing corporation as a party defendant in an action pending against the seller. The denial of that motion, affirmed by the Supreme Court, shows that under the Act of 1874, the purchasing corporation does not succeed, simply by operation of law, to the liabilities of the seller. Accordingly, we think the case at bar is governed by our decision in American Gas & Elec. Co. v. Commissioner, supra."

It is true that the Act of 1874 does not contain a provision imposing liability on the successor corporation for the debts and torts of the merged corporation. But the absence of such a provision from early consolidation and merger statutes is not unusual. The question of liability of the successor corporation in such cases has been passed upon by this Court and the Courts of several of the states.

In *Mt. Pleasant v. Beckwith*, 100 U. S. 514, a town had issued bonds and later had been merged into other towns by an Act of the Legislature. A bond holder sued the successor towns on the bonds. The Act merging the towns made no provision for payment of the bonds. In holding that the successor was liable for the debt this Court said:

> "Speaking to the same point, the Supreme Court of Missouri held that where one corporation goes entirely out of existence by being annexed to or merged in another, if no arrangements are made respecting the property and liabilities of the corporation that ceases to exist, the subsisting corporation will be entitled to all the property and be answerable for all the liabilities. *Thompson v. Abbott*, 61 Mo., 176, 177.
>
> "Grant that, and it follows that when the corporation first named ceases to exist there is then no power

left to control in its behalf any of its funds, or to pay off any of its indebtedness. Its property passes into the hands of its successor, and when the benefits are taken the burdens are assumed, the rule being that the successor who takes the benefits must take the same *cum onere*, and that the successor town is thereby estopped to deny that she is liable to respond for the attendant burdens. * * *

"* * *

"Neither argument nor authority is necessary to prove that a State legislature cannot pass a valid law impairing the obligations of a contract, as that general proposition is universally admitted. Contracts under the Constitution are as sacred as the Constitution that protects them from infraction, and yet the defense in this case, if sustained, will establish the proposition that the effect of State legislation may be such as to deprive a party of all means of sustaining an action of any kind for their enforcement. * * *

"* * *

"When the appellant towns accepted the annexation, their authorities knew, or ought to have known, that the extinguished municipality owed debts, and that the Act effecting the annexation made no provision for their payment. They had no right to assume that the annulment of the charter of the old town would have the effect to discharge its indebtedness, or to impair the obligation of the contract held by its creditors to enforce the same against those holding the territory and jurisdiction by the authority from the legislature and the public property and the power of taxation previously held and enjoyed by the extinguished municipality.

"* * *

"Extensive powers in that regard are, doubtless, possessed by the legislature; but the Constitution provides that no State shall pass any 'law impairing

the obligation of contract,' from which it follows that the legislature, in the exercise of any such power, cannot pass any valid law impairing the right of existing creditors of the old municipality * * *"

In 1893, the Court of Appeals of Maryland, considering the effect of a consolidation under a general act of the legislature which made no provision with respect to the debts of the consolidating corporations (see Appendix E), in *Dodson v. Baltimore and Lehigh R. R. Co. et al.*, 77 Md. 489, held the successor corporation liable therefor, saying:

"* * * The legal consequences of this consolidation must depend on the Act of Assembly by which it was authorized. The Act of 1890, ch. 553, contains very few details; it enables two railroad companies, whose tracks form a continuous line, to consolidate with each other. It must be the result of this proceeding that the two original corporations cease to exist, and a third one comes into being, which comprehends both of them. It is composed of both; it is in effect both united into one. Nothing is destroyed by the consolidation; whatever appertained to either of the constituent bodies, now, in the same measure and under the same conditions, appertains to the composite body. It was the intention of the Legislature to enable the consolidating corporations to do more efficiently what they had the power to do before. It could not have been the purpose to deprive them of any rights, property or credits which they previously had; neither was it the purpose to relieve them from any responsibilities which they had incurred. The design was to gather into one all the concerns of each of them, and vest them in the corporation formed by their union.

"The new corporation thus created was in reality the embodiment under another name of the two formerly existing. They had been joined together in

every faculty and function, and molded into an indivisible unity, with none of their rights impaired, and none of their responsibilities abated. If this were not the result of the consolidation, very great inconvenience and injustice would arise. The Act of Assembly enables two corporations to consolidate upon such terms as may be agreed upon. This agreement refers to the adjustment of the interest of the stockholders, and the settlement of the terms on which they shall hold the stock of the new company, and to matters belonging to the organization of the new corporation and such like things. Whatever else it may be competent to determine by agreement, the combining companies could not, by any contract between themselves, conclude the rights of persons who had been injured by their *torts*. Their agreement to consolidate brings the new corporation into existence, and then its liabilities are determined by the just construction of the statute, which authorizes the consolidation. * * *"

In addition to the cases above cited, the courts of Indiana, Kansas, Mississippi, Missouri and Virginia have held that notwithstanding the absence of a statutory provision imposing liability on the successor corporation, it is liable on one of the two following theories:

(a) The debts and liabilities "become by implication the obligations of the new corporation." *Louisville, New Albany & Chicago Ry. Co. v. Boney*, 117 Ind. 501, 20 N. E. 432 (1889); *Berry v. Kansas City, Ft. Scott & Memphis R. R. Co.*, 52 Kans. 774, 775 (1894); *Thompson v. Abbott*, 61 Mo. 176 (1875); *Morrison v. American Snuff Co.*, 79 Miss. 330 (1901); *American Ry. Express Co. v. Downing*, 132 Va. 139, 111 S. E. 265 (1922). In the latter case the Court said:

"Many of the authorities, *in the absence of statute fixing the liability* (which is the situation touching

the case in judgment), regard the liabilities of the consolidated corporation for the unsecured debts of its constituent companies as in truth resting upon the agreement, express or implied, of the consolidated corporation to pay such debts; and this, we think, upon principle, is, in such case, the true ground on which the obligation rests.

"In *Morrison v. American Snuff Co.*, 79 Miss. 330, 30 So. 723, 89 Am. St. Rep. 598, this is said: 'The foundation of the liability of a consolidated corporation may rest on a statute, or on an agreement, either express or implied. *If the statute does not provide that the new company shall assume the debts and liabilities of the constituent companies,* and there is no expressed agreement respecting the same, the debts of the original companies follow as an incident of the consolidation and become by implication the obligations of the new corporation.' (Citing authorities.)

"The consolidated company has in its hands property which, in equity and good conscience, belongs to the plaintiff to the extent of having his claim satisfied thereby; and, wherever property, or money, is so held, 'the law operating on the acting parties creates the duty, establishes the privity and implies the promise and obligation on which the action is founded.' *Brewer v. Dyer*, 7 Cush. (Mass.) 339. See to the same effect, *Moses v. Macferlan*, 2 Burrow 1012; Clark on Contracts, sec. 314, p. 757; *Norfolk v. Norfolk County*, 120 Va. 356, 91 S. E. 820; 2 R. C. L., sec. 9, pp. 749-750.

"Where the circumstances are such that the law implies the promise on the part of the consolidated corporation to pay the liabilities of the constituent companies, the situation is precisely the same in principle, as if such promise were an express promise; and the plaintiff for whose benefit such promise exists may recover upon it by action at law against the promisor, upon either of the principles aforesaid. * * *" (Italics added.)

(b) "The Consolidated Company should be deemed to be merely the same as each of its constituents, their existence being continued in it under the new form and name, their liabilities still existing as before, and capable of enforcement against the new company as if no change had occurred in its organization or name." *The Indianapolis, Cincinnati and Lafayette R. R. Co. v. Jones*, 29 Ind. 465 (1868); *Langhorne v. Richmond Ry. Co.*, 91 Va. 369, 22 S. E. 159 (1865). Judge Thompson, in the first edition (1899) of his works on *Corporation* (Volume 7, p. 6978), stated the principle of these cases as follows:

> "• • • The consolidation of two or more corporations is like the uniting of two or more rivers; neither stream is annihilated, but all continue in existence. A new river is formed, but it is a river composed of the old rivers, which exist though in a different form. So it is with a consolidated corporation. A new corporation is formed, but not in the sense which works a destruction of the rights of action existing against the old one. Independently of statute, the better view is that the new one is liable for any debts, obligations, or rights of action of any kind existing in favor of third persons at the time of the consolidation, and may be sued, at law or in equity, to enforce such rights and obligations without agreement to become so answerable, and without any statute imposing the liability."

In *Railroad Company v. Jones, supra*, the Supreme Court of Indiana, after stating the above quoted conclusion, added: "This doctrine seems to spring from the necessities of justice, and, so far as we are able to foresee, cannot result in wrong or in embarrassment." This is, in effect, an application of the common law principle of implied contracts which Blackstone in his Commentaries, Vol. 2, p. 443, defined as "such as reason and justice

dictate, and which therefore the law presumes that every man undertakes to perform."

Petitioner asserts (Petitioner's Brief, pp. 28-29) that "It is only where the statute governing consolidations or mergers requires the successor to assume the debts and permits that corporation to be sued upon them as if they were its own debts, that there is liability by operation of law." Petitioner has not cited a single case in support of this statement except the case of *General Gas and Elec. Corp.* now before this Court, and we submit that this assertion is contrary to all other authority on the subject.

E. The Case of Merwine v. Mt. Pocono Light & Improvement Company, 304 Pa. 517.

The Circuit Court of Appeals for the Second Circuit in the *General Gas & Electric Corporation* case coupled the absence from the Act of 1874 of a provision making the successor corporation liable for the debts of its predecessor with the refusal of the Court in the *Merwine** case to substitute the successor corporation as defendant in a suit for a tort committed by the merged corporation as showing "that under the Act of 1874, the purchasing corporation does not succeed, simply by operation of law, to the liabilities of the seller".

We submit that the Court misinterpreted the Merwine decision.

In that case the appellant had sued to recover damages for personal injuries. Defendant's attorneys filed a suggestion setting forth that subsequent to the date of commencing the action the property and franchises of the defendant had been conveyed to Pennsylvania Power & Light Co. in proceedings under the Act of 1874, as amend-

* In Petitioner's Brief, p. 25, he inadvertently states that Respondent was the successor corporation in *Merwine v. Mt. Pocono Lt. & Imp. Co.* Respondent is in no way connected with Pennsylvania Power & Light Company, or its holding company, it being an independent operating company.

ed; they alleged that under the Act the defendant had ceased to exist and prayed that the action should be abated. Plaintiff filed an answer and prayed that a rule be allowed to show cause why the Pennsylvania Power & Light Co. should not be substituted as defendant. Pennsylvania Power & Light Co. then interposed the statute of limitations as its defense. The court below abated the action and denied the prayer of the plaintiff.

Two questions, therefore, were before the Supreme Court: did the court below err (1) in abating the action against the Mt. Pocono Company, and (2) in refusing to substitute Pennsylvania Power & Light Company as defendant.

(1) In determining the first question, the Court considered the provision of the Act of 1874 that upon completion of the transaction authorized thereby "such corporation shall cease to exist". It pointed out that the defendant was seeking to avoid liability on the ground that it no longer existed, but that the Act "obviously was not intended to work such hardship," and although the defendant did cease to exist for the purpose of carrying on the business for which it was created, "we find nothing in the statute * * * which forces upon the creditor-plaintiff the injustice of having her suit, which must be presumed to be based upon a legitimate claim, summarily abated". In arriving at this conclusion the Court referred, by way of analogy, to several examples of protection given creditors, among them being the reversal of the common law doctrine that debts were totally extinguished upon the civil death of a corporation; the continued liability of a corporation after dissolution under the Act of the Commonwealth of Pennsylvania of May 21, 1881, and the holding by the Supreme Court of Pennsylva-

nia in the case of *B. & S. R. R. Co. v. Musselman* (quoted, *infra*, pp. 43-44) that suits pending against corporations which consolidated did not abate.

The Court held, therefore, that the action against the Mt. Pocono Company did not abate, and ruled

> "* * * that the proper course at the present state of proceedings requires plaintiff first to proceed to judgment against defendant [Mt. Pocono Co.] if she can, and, having secured judgment, to levy where defendant's assets liable for the judgment may be found" [i. e., seize the property in the hands of Pennsylvania Power & Light Co.]. (Matter in brackets added.)

That this was the intent of the direction is made clear in *Weinroth v. Homer B. & L. Association*, 310 Pa. 265, where, in referring to the *Merwine* case, the Court said:

> "The court there directed plaintiff, if he recovered judgment, to pursue the property of the defendant in the possession of the *merged* company."

In other words, the Court held that the words "cease to exist" in the Act of 1874 meant that the Mt. Pocono Company's right to carry on business had been terminated, but it remained a corporation for the single purpose and with the sole power of being sued or proceeded against and defending itself in causes of action brought against it before the consummation of the transaction. If it were subjected to judgment, levy would be made against Pennsylvania Power & Light Company.

The status of the Mt. Pocono Company, as defined by the Court, is entirely consistent with the previous consummation of either a merger or a consolidation. In *American Ry. Exp. Co. v. Downing*, 132 Va. 139, *supra*, pp. 31-32, the Court said:

"It is not essential to the new corporation being considered as a *consolidated company,* within the meaning of those terms as used in the authorities * * * nor to the liability of the new corporation above referred to, that the constituent companies should cease to exist *de jure* upon the organization of the new corporation. The going 'out of existence' of the constituent companies * * * is the cessation of all actual transaction of business as a going concern —the *de facto* cessation of all business—the abandonment of all life and operation according to the design of the charter of the constituent companies. The continued existence *de jure* of the constituent companies, for the purpose of winding up their affairs or other purposes, is immaterial. * * *"

This subject is further discussed at pages 43-45 of this brief.

(2) In support of the alternative contention that the court below erred in refusing to substitute Pennsylvania Power & Light Co. as defendant, counsel for appellant had contended in his brief (p. 518 of opinion) that "The transaction was a merger, not a sale." In considering this contention, the Court said, at pages 524-525:

"Although we need not decide the point, it is proper to call attention to the fact that the pleadings indicate that the Pennsylvania Power & Light Company took over the property of defendant under circumstances warranting a finding, upon evidence produced to support the allegations in the pleadings, *that the transaction between the two corporations was in reality a merger, or such union of interests as, in law, caused the buying corporation to assume defendant's obligations.* There is much to show that the purchase was attended by an intimacy of interest tending to render the transaction, in so far as the Pennsylvania Power & Light Company's interest

was concerned, a purchase cum onere. For instance, it is averred that, at the time of the commission of the alleged negligent acts on the part of the Mount Pocono Light & Improvement Company, it was affiliated or associated with the Pennsylvania Power & Light Company to the extent that both companies were managed, operated and controlled under the same management and system. It is admitted that the common stock of both companies was owned by the same holding company, and, by defendant's own showing, thirteen of the same persons were officers or directors in both companies. It further appears that both companies operated from the same office. Plaintiff states that the business of the Mount Pocono Company was conducted by the agents, servants and employees of the Pennsylvania Power & Light Company; that after the sale, the power company took over and operated the business formerly conducted by defendant; and that the sale was merely a formality giving effect to a union of the companies which had in reality occurred previous to the accident upon which the suit is based. * * *" (Italics added.)

This is a definite statement by the Court that the transfer by the subsidiary corporation (under the procedure prescribed by the Act of 1874, as amended) of its franchises and property to the corporation with which it was affiliated, under circumstances similar to those of the case at bar, was merely a formality and the transaction in reality was a merger of the two companies, the corporation acquiring the franchises and property becoming liable *by operation of law* for the torts and debts of the merged subsidiary.

Nowhere did the Court say in the *Merwine* case that the successor corporation, Pennsylvania Power & Light Co., could not be sued by the plaintiff. Indeed, the Court, although saying it did not decide the point, expressly called

attention to the fact that the contrary was the case if the allegations of the pleadings were proved.

The plaintiff's prayer in the *Merwine* case that Pennsylvania Power & Light Co. be substituted as defendant was an alternative in the event that the suit against the Mt. Pocono Company abated, and the Court, having held that it did not abate, affirmed the order of the lower court denying the substitution, but expressly "without prejudice to plaintiff".

The results of the *Merwine* case, namely,

(1) the holding that the plaintiff's suit against the merging subsidiary was not abated; that the suit might be pursued to judgment, and levy made against the property in the hands of the successor, and

(2) the indication of the Court that the successor was liable because "the pleadings indicate * * * that the transaction between the two corporations was in reality a merger, or such union of interest as in law caused the buying corporation to assume the defendant's obligations,"

are exactly the same as the result of a merger under Article IX of the Pennsylvania Corporation Laws of 1933, Section 907 of which provides:

> "* * * any claim existing or action or proceeding pending by or against any of such corporations may be prosecuted to judgment as if such merger * * * had not taken place, *or* the surviving * * * corporation may be proceeded against or substituted in its place. * * *"

Mr. Shockley in his annotation of this section notes that similar provisions are in the Uniform Business Corpora-

tion Act (Sec. 47), approved by the National Conference of Commissioners on Uniform State Laws, and the Corporation Laws of Delaware, New Jersey, New York, Maryland, Indiana, Ohio, Michigan and California.

Petitioner admits (Petitioner's Brief, p. 26) that the Court, in the *Merwine* case, "did suggest that * * * the purchaser might be liable for the debts of the seller," but he says the Court "made no suggestion that it was liable under the statute itself." We have shown above (pp. 28-34) that the omission of such a provision from the early merger and consolidation statutes was not unusual, but notwithstanding this fact the successor was held liable. The phrase liability "by operation of law" expresses the manner in which liabilities devolve upon a person by the application to the particular transaction of established rules of law without any specific act of the party himself. The liability is equally "by operation of law" whether specifically provided by statute or imposed upon the successor by the courts as a necessary result of the transaction.

That this is true is apparent from the opinion of the Circuit Court of Appeals for the Second Circuit in *American Gas & Electric Co. v. Commissioner*, 85 Fed. (2d) 527, 531, in which the Court, in permitting the successor corporation to deduct discount on bonds issued by its predecessor, relied upon *American Ry. Exp. v. Downing*, 132 Va. 139 (see *supra*, pp. 31-32) as showing that "the transferee corporation succeeds by operation of law to all the rights and liabilities of the former company." In that case no liability was imposed upon the successor by statute, nevertheless the Court held the successor liable as an implication of the transaction.

F. Liability of Successor Corporation on Principle of Fraudulent Conveyance

Petitioner contends (Petitioner's Brief, p. 27) that the Supreme Court of Pennsylvania, in the *Merwine* case, by its reference to "a purchase *cum onere*" meant that the successor was liable on the principle of fraudulent conveyances.

The phrase "*cum onere*" does not imply a fraudulent conveyance. This Court, in *Mt. Pleasant v. Beckwith*, 100 U. S. 514 (*supra*, pp. 28-30), in considering a merger of towns by an Act of the legislature, rested liability of the successor on "the rule • • • that the successor who takes the benefits must take the same *cum onere*," yet it is impossible to apply to that case the principle of fraudulent conveyances. The same is true of the case of *Thompson v. Abbott*, 61 Mo. 176, 177, *supra*, pp. 28, 31, cited with approval by this Court in the above case.

In none of the cases above referred to (pp. 28-34), in which the consolidated corporation was held liable for debts of the predecessor in the absence of statutory provision, did the court rest such liability on the principle of fraudulent conveyance.

Creditors' remedies in mergers, consolidations and fraudulent conveyances are similar in that one of the remedies allowed creditors in Pennsylvania in the case of mergers and consolidations and also one of the remedies in case of fraudulent transfers, where the purported sale is treated as a nullity, is to levy directly on the assets in the hands of the holder. This similarity of remedy, however, does not mean that either mergers or consolidations are fraudulent transfers. Thus, in

Berkovitz's Appeal, 319 Pa. 397, the Supreme Court of Pennsylvania noted the similarity of remedy, saying:

> "• • • we have also decided in other cases that creditors of one corporation may follow the property or assets of such corporation into a new corporation where there has been a merger, *or*, in cases of fraudulent transfer. See Halpern v. Grabosky, 296 Pa. 108, 111; Merwine v. Mt. Pocono, 304 Pa. 517, 522; Delphia Knitting Mills Co. v. Richards, 62 Pa. Superior Ct. 9, 12." (Italics added.)

In the *Merwine* case the Court referred to the note to *Mumma v. The Potomac Co.*, 8 Peters 281, printed in 8 L. Ed. at pp. 945-946, stating that the common law doctrine that upon the civil death of a corporation all debts due to or from it were totally extinguished had been superseded by the trust fund doctrine under which a court of equity will lay hold of the funds of such a corporation and see that they are applied to the payment of debts. This reference to the trust fund doctrine was not intended by the Court to indicate that in the case of a merger a creditor of the merging corporation would have to apply to a court of equity for the enforcement of his claim, but was simply an illustration of the fact that courts will not, in this age, permit just claims to be defeated on technical grounds.

G. Continuance of the Existence of Merging or Consolidating Corporations Within the Successor.

Petitioner in his brief repeatedly asserts that one of the essentials of a true merger or consolidation is the preservation of the existence of the transferor corporations within the successor corporation. He cites *American Gas and Elec. Co. v. Commissioner*, 85 Fed. (2d) 527, *American Gas and Electric Co. v. United States*, 17 F.

Supp. 151, and *General Gas and Elec. Corp. v. Commissioner,* now before this Court, in support of this assertion (Pet.'s Brief, p. 29). The statement in these cases that the merger or consolidation transaction must be one "which essentially preserved the identity of the transferor" within the transferee is simply a way of expressing the idea that in a true merger or consolidation there must be an amalgamation of interests, as contrasted from a divorcement, and the property, powers and franchises of the merging corporations must be transferred as an entirety to the successor corporation, subject to its debts and liabilities, and thereafter the merging corporations cease to exist in the sense that they have been stripped of all property, rights and franchises and cannot engage in business.

It does not mean, as Petitioner contends in his brief, that the transferring corporation must cease to exist in the absolute sense, and cannot remain alive for the special purpose of defending or prosecuting suits. The Supreme Court of Pennsylvania made this clear as far back as 1856 in the case of *Balto. and Susq. R. R. Co. v. Musselman,* 2 Grant's (Pa.) Reports 348. The question in that case was whether a suit brought against the Railroad Company prior to its consolidation had been abated by reason of the "death" of the corporation in the consolidation proceedings. In holding that the suit had not abated because of a provision of the statute authorizing the consolidation, the Court said—

> "But, without any such provision as the above, in the law authorizing the consolidation [referring to the provision making the merging corporations liable for their debts] a court of justice would not consider the mere voluntary union of several corpo-

> rations into one, as equivalent to the death of either * * *. It is not a case of death, for the new corporation lives from the life of the old one; their several lives are transferred into it; and unlike ordinary cases of metempsychosis, this translation is accompanied by full consciousness of the former state, and its liabilities."

The Court therefore held that while there was what might be termed a "reincarnation" of the constituent corporations in the successor, the constituent corporations remained alive for the purpose of defending suits.

As pointed out in this brief at pp. 39-40, the Pennsylvania Corporation Law of 1933, Sec. 47 of the Uniform Business Corporation Act and the laws of many states provide that after mergers or consolidations, suits may be prosecuted against the constituent corporations.

The idea of the continued existence of the transferring corporation within the successor is thus expressed in *Mercantile Trust Co. v. San Joaquin Agricultural Corporation*, 89 Cal. App. 558, 265 Pac. 583 (1928)—

> "It is true that each of the consolidated banking corporations, as a distinct, independent, and separate corporate entity, practically passes out of existence or becomes extinct upon completion of the act of consolidation. But, unlike in cases of dissolution, their corporate activities do not cease but are continued and are prosecuted and carried on through a new channel—a channel created solely by their voluntary act under the sanction of the law for that specific purpose. Speaking figuratively, the act of consolidation is merely the joint transfusing of the blood of the constituent corporations into the veins and arteries of a new single corporate entity, that they may enlarge and extend the scope and business ram-

ifications of their own corporate purposes and also to impart enhanced solidity to their responsibility as banking and trust corporations."

We submit that the existence of the Holtwood Company was continued within Respondent. Under the Act of 1874 "its franchises, (this term being "generic" and meaning all the rights granted by the legislature, *Atl. and Gulf R. Co. v. Georgia*, 98 U. S. 359, 365) and all its property, real, personal and mixed" were transferred to Respondent, which became liable by operation of law for Holtwood Company's debts.

The Act of 1874 expressly provides that upon the completion of such a transaction the transferring "corporation shall cease to exist." It is true that in the case of *Merwine v. Mt. Pocono Lt. & Imp. Co., supra*, the Supreme Court of Pennsylvania held that the transferring corporation had not passed out of existence in the absolute sense and an action brought against it prior to the merger had not abated. But the Court did point out that if such a corporation attempted to resume business, it could be stopped by a quo warranto proceeding. This holding was in accord with the accepted rule as to the status of a merging corporation.

H. If Merger Had Not Taken Place Deduction of Bond Discount and Expense Would Not Have Been Questioned by Petitioner.

If the merger of Holtwood Company into Respondent had not taken place in 1927 the unamortized bond discount and expense would have been deductible by Respondent whether separate or consolidated tax returns were made.

Paragraph 3 (c) of the agreement of August 26th, 1924, between Holtwood Company and Respondent (R. 34-35) obligated Respondent to pay to Holtwood Company "A sum to provide for amortization of debt, discount, and security issue expense." This provision would have required Petitioner (if separate tax returns had been made) to admit Respondent's right, in computing its income tax, to deduct the unamortized discount and expense paid to Holtwood Company because the payment of these items would have been part of the cost of the power delivered to Respondent from Holtwood's plant. These payments to Holtwood Company would have been considered as income to that Company, but the whole amount thereof would have been deductible by it as expense, so there would have been no income tax assessable against Holtwood Company as a result of the transaction.

Section 142 of the Revenue Act of 1928 authorized corporations with common ownership to make consolidated tax returns. The purpose of this section was to provide a method of computing the tax upon the true net income of a business which was in reality a single enterprise though conducted by two or more corporations. *Atlantic City Elec. Co. v. Commissioner*, 288 U. S. 152. p. 154. From the time of the incorporation of the Holtwood Company to its merger with Respondent consolidated tax returns were made for these corporations. If the merger had not taken place, a consolidated return would doubtless have been made for 1928. In such a return, inter-company transactions would have been eliminated and the unamortized discount and expense deductible in computing Respondent's taxable income. (Statement of Evidence, par. 9, R. 30-31.)

Respondent, therefore, is not endeavoring to obtain any additional deduction from income by reason of the merger. It contends that it would be unjust to require it to pay a large tax because of a technical change in the title to its steam generating plant which was purely a formality and did not involve any change in substance.

I. Cases Disallowing Deductions of Discount to Successor Corporation Distinguished.

The case at bar is clearly distinguishable from the cases in which deductions on account of amortization of bond discount and expense have been disallowed to successor corporations, viz., *Turner-Farber-Love Co. v. Helvering*, 68 Fed. (2d) 416 (1933); *American Gas & Electric Co. v. Commissioner*, 85 Fed. (2d) 527 (1936); and *American Gas & Electric Co. v. United States*, 17 Fed. Sup. 151, 85 Ct. Cl. 92 (1936). In these cases the corporations did not merge or consolidate, and the transactions in question were simply sales of the assets of one corporation to another for either cash or marketable securities. The vendor corporation was not dissolved by operation of law but could continue "to do any business its corporate charter authorized," and further, as the Circuit Court of Appeals and the Court of Claims suggested in the *American Gas & Electric Co.* case, the purchase price was such that it could be and probably was adjusted because the vendee would have to pay the bonds in full. No consideration was paid by Respondent to Holtwood Company which could be adjusted, or reduced, because of the unamortized discount and expense. Upon the completion of the "short form" merger Holtwood Company "ceased to exist" as provided in the Act of 1874, as amended, and it therefore could not engage in any business.

J. Cases Denying to Successor Corporations Deductions for Losses Suffered by Predecessors.

Petitioner refers (Petitioner's Brief, pp. 39-41) to the following cases holding that a successor corporation taking over the assets of another and assuming its liabilities is not entitled to deduction for losses which the predecessor might have claimed: *New Colonial Co. v. Helvering*, 292 U. S. 435; *Athol Mfg. Co. v. Commissioner*, 54 Fed. (2d) 230 (C. C. A. 1); *Brandon Corp. v. Commissioner*, 71 Fed. (2d) 762 (C. C. A. 4); *Cem Securities Corp. v. Commissioner*, 72 Fed. (2d) 295 (C. C. A. 4); *May Oil Burner Corp. v. Commissioner*, 71 Fed. (2d) 644 (C. C. A. 4); *Shreveport Producing & Refining Co. v. Commissioner*, 71 Fed. (2d) 972 (C. C. A. 5); *Dalton v. Bowers*, 287 U. S. 404; *Burnet v. Clark*, 287 U. S. 410; *Burnet v. Commonwealth Imp. Co.*, 287 U. S. 415; *Planters Oil Co. v. Hopkins*, 286 U. S. 332.

These cases have no application to the case at bar because they all relate to losses sustained by the predecessor prior to the transfer of its property.

Bond discount is in reality deferred interest although the payment of it has been called a loss. Thus in *W. Md. Ry. Co. v. Commissioner*, 33 Fed. (2d) 695, 696, the Court said—

> "Bond discount is in reality additional interest payable upon the maturity of the bonds, and a proportionate part of it accrues each year and should be treated as interest paid or accrued on the bonds for that year."

Also see:

Chicago, R. I. and Pac. Ry. Co. v. Commissioner, 13 B. T. A. 988, 1031, 1033.

The Circuit Court of Appeals for the Second Circuit in holding, in the case of *New York Cent. R. R. Co. v. Commissioner*, 79 Fed. (2d) 247, 249, that bond discount on bonds issued by a predecessor was deductible by the successor either by consolidation or merger, said:

> "In the case at bar, no loss was sustained by the issuing corporations in selling their bonds at a discount; the loss will be sustained by the consolidated corporation when the bonds mature and are paid. Hence the deductions here in question are by way of anticipation of the taxpayer's own loss and should have been allowed."

To the same effect is *Helvering v. Union R. R. Co.*, 293 U. S. 282, 286, 287.

Whether unamortized bond discount paid at the time of calling bonds prior to maturity is called deferred interest or loss is immaterial. Under either theory it is an expense of the successor corporation and not a loss of the predecessor corporation which issued the bonds.

Petitioner says in his brief at p. 46 that the Circuit Court of Appeals for the Second Circuit repudiated the above quoted statement in the *New York Cent.* case in its subsequent decision in *American Gas and Elec. Co. v. Commissioner*, 85 Fed. (2d) 527, and held that the bond discount loss was an expense of the issuing corporation. We do not so read the opinion. In speaking of the bonds of the Virginian Power Co. and Electric Company of New Jersey the Court said—

> "• • • Where, however, there is a transfer in a reorganization, the loss is likewise that of the issuing corporation, for the reason that, because of the discount and expenses, it had subjected itself to an obligation larger than the amount it received from the bonds. *Because of this increased obligation, the*

transferor necessarily obtained a less valuable consideration from the transferee at the time of the transfer in reorganization than it would otherwise have received. Nevertheless, under section 203(b)(4) of the Revenue Acts of 1924 and 1926, no gain or loss is to be recognized upon the transfer. Consequently, where there has been only a partial amortization of discount and expenses and a transfer in reorganization occurs, no further loss will be recognized, and that part of the loss which could not be taken prior to the transfer cannot be taken thereafter. * * *" (Italics added.)

In other words, the purchase price was adjusted for the discount so the loss actually fell upon the issuing corporation. It could not deduct the loss for the reason given by the Court, neither could the transferee take it because it sustained no loss in view of the adjustment in the purchase price.

In considering the bonds of the Appalachian Power Company the Court held that the allowance of the bond discount was governed by its decision in the *New York Cent.* case because there was a merger of the issuing corporation into the Appalachian Electric Power Company.

IV.

THE TRANSACTION IN QUESTION INVOLVED A CHANGE IN FORM ONLY AND THEREFORE THE DEDUCTIONS SHOULD BE ALLOWED IRRESPECTIVE OF THE TECHNICAL NATURE OF THE TRANSACTION.

Holtwood Company, prior to the consummation of the "short form" merger, was simply a department of Respondent in method of operation of its steam-electric generating plant as well as through stock ownership (R. 29-30). After the consummation of the "short form" merger, Respondent was in exactly the same position as be-

fore; its officers and employees were the same; the interests of stockholders were the same and its assets and liabilities were the same. The only difference was that Respondent had title to the steam generating plant directly instead of through a wholly owned agent which had been subject in all things to its direction and control.

In the case of *New Colonial Ice Co. v. Helvering*, 292 U. S. 435, 442, cited by Petitioner, this Court said:

> "As a general rule a corporation and its stockholders are deemed separate entities and this is true in respect of tax problems. Of course, the rule is subject to the qualification that the separate identity may be disregarded in exceptional situations where it otherwise would present an obstacle to the due protection or enforcement of public or private rights."

The case of *Southern Pacific Company v. Lowe*, 247 U. S. 330, pp. 337, 338, was referred to (footnote 5) as an example of an "exceptional situation" in which for income tax purposes the separate corporate entity of a wholly owned subsidiary of a railroad should be disregarded. In holding that dividends paid by a subsidiary to its parent company in 1914 from surplus accumulated prior to the adoption of the 16th Amendment were not taxable income, the Court said:

> "We base our conclusion in the present case upon the view that it was the purpose and intent of Congress, while taxing 'the entire net income arising or accruing from all sources' during each year commencing the first day of March, 1913, to refrain from taxing that which, in mere form only, bore the appearance of income accruing after that date, while in truth and in substance it accrued before; and upon the fact that the Central Pacific and the Southern Pacific were in substance identical because of the complete ownership and control which the latter pos-

sessed over the former, as stockholder and in other capacities. While the two companies were separate legal entities, yet in fact, and for all practical purposes, they were merged, the former being but a part of the latter, acting merely as its agent, and subject in all things to its proper direction and control. * * *"

Western Maryland Railway Co. v. Commissioner, 33 Fed. (2d) 695 (C. C. A. 4) (1929), was the first case in which an issue similar to that in the case at bar was considered by the courts. The question there was whether Western Maryland Railway Co., which was formed by the consolidation of its predecessor with seven subsidiaries, all of whose stock it owned and whose property it operated as its own, was entitled to amortize and deduct discount on bonds issued by its said predecessors. The Interstate Commerce Commission required that the unamortized discount be carried on the balance sheet of the consolidated company and amortized over the remaining life of the bonds (which fact is equally true in the case at bar under the accounting rules of the Public Service Commission of Pennsylvania, see R. 32). The Board of Tax Appeals denied the deduction and the Railway Co. appealed.

In reversing the decision of the Board of Tax Appeals, the Court relied upon the principle illustrated by the two cases above cited, saying:

"We come then to the second question in the case: Has the right to deduct the amortized portion of the discount been lost by reason of the reorganization of the corporation that sold the bonds and the taking over of its assets and liabilities by the consolidated company? We think not. In the first place, it is perfectly clear that, although there has been a reorganization and although the consolidated corporation is a distinct legal entity from those whose places

it has taken, nevertheless, in all of its essential relationships, it occupies exactly the same position which they occupied. Its management is the same, its assets are the same, its stockholders are the same, and its obligations are the same, except that the floating indebtedness of the old corporation has been taken up by the first preferred stock of the new, a change which might have been effected by the old corporation without reorganization, and which manifestly can have no bearing upon the matter of bond discount. In other words, the consolidated corporation has stepped into the place of the corporation which issued the bonds, and occupies the same relationship towards them that it occupied. It has received no consideration for its agreement to pay them except the assets of the old corporation which have been transferred to it. It has the same property as the old corporation, owes the same bonded debt, and is bound to pay it in the same way. The Interstate Commerce Commission requires that the unextinguished discount be carried on the balance sheet of the company and that same be amortized by charge against income for the remaining life of the bonds, just as though no reorganization had taken place; and, if the deduction is to be allowed as a basis for rate making and for determining the rights of the government under the recapture clause of the Transportation Act, there is no reason why it should not be allowed in determining the basis of taxation also. *After all, while there is a technical legal difference between the old and the new corporations, they are the same as a practical matter, both holding the same property and representing the same ownership, and it is a settled principle that 'courts will not permit themselves to be blinded or deceived by mere forms of law but, regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require'.* Chicago, Milwaukee & St. Paul R. Co. v. Minneapolis Civic

Ass'n., 247 U. S. 490, 501, 38 S. Ct. 553, 557 (62 L. Ed. 1229); Southern Pac. Co. v. Lowe, 247 U. S. 330, 38 S. Ct. 540, 62 L. Ed. 1142; Gulf Oil Corporation v. Lewellyn, 248 U. S. 71, 39 S. Ct. 35, 63 L. Ed. 133.

"The rule just stated is of peculiar importance in tax cases; for, unless the courts are very careful to regard substance and not form in matters of taxation, there is grave danger on the one hand that the provisions of the tax laws will be evaded through technicalities and on the other that they will work unreasonable and unnecessary hardship on the taxpayer. It is instructive to note the many tax cases decided in recent years in which the courts have not hesitated to ignore corporate forms, and to decide the questions involved in the light of what the parties have actually done, rather than on the basis of the forms in which they have clothed their transactions. See Weiss v. Stearn, 265 U. S. 242, 44 S. Ct. 490, 68 L. Ed. 1001, 33 A. L. R. 520; U. S. v. Phellis, 257 U. S. 156, 42 S. Ct. 63, 66 L. Ed. 180; Eisner v. Macomber, 252 U. S. 189, 40 S. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570; Gulf Oil Corp. v. Lewellyn, supra; Alpha Portland Cement Co. v. U. S. (C. C. A. 3d), 261 F. 339; Appeal of A. J. Siegel, 4 B. T. A. 186; Appeal of H. E. Brubaker, 4 B. T. A. 1171. *We think, therefore, that as the new corporation, while technically a distinct legal entity, is to all practical intents and purposes a mere continuation of the old, it is entitled to the same deduction on account of amortized bond discount that the old corporation would have been entitled to if the reorganization had not taken place."* (Italics added.)

This rule of disregarding corporate entity, we contend, should be applied in the case at Bar. Holtwood Company and Respondent were for all practical purposes merged from the date of the organization of the Holtwood Company. Respondent, therefore, should not be required to

ay the tax in question because it went through the for-
nality of eliminating a legal concept—Holtwood Com-
any—after its maintenance was found to be no longer
ecessary in order to comply with the laws of Pennsyl-
ania.

CONCLUSION.

The decision of the Court below was right and should be
ffirmed.

Respectfully submitted,

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February 2, 1939.

APPENDIX A.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title.

* * * * * *

(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

United States Internal Revenue Regulations No. 74.

Art. 68. *Sale and retirement by corporation of its bonds.*—(1) (a) If bonds are issued by a corporation at their face value, the corporation realizes no gain or loss. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price

or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

(2) (a) If bonds are issued by a corporation at a premium, the net amount of such premium is gain or income which should be prorated or amortized over the life of the bonds. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price minus any amount of premium already returned as income, the excess of the purchase price over the issuing price minus any amount of premium already returned as income (or over the face value plus any amount of premium not yet returned as income) is a deductible expense for the taxable year. (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price minus any amount of premium already returned as income, the excess of the issuing price minus any amount of premium already returned as income (or of the face value plus any amount of premium not yet returned as income) over the purchase price is gain or income for the taxable year.

(3) (a) If bonds are issued by a corporation at a discount, the net amount of such discount is deductible and should be prorated or amortized over the life of the bonds. (b) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price plus any amount of discount already deducted, the excess of the purchase price over the issuing price plus any amount of discount already deducted (or over the face value minus any amount of discount not yet deducted) is a deductible expense for the taxable year. (c) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price plus any amount of discount already deducted, the excess

of the issuing price plus any amount of discount already deducted (or of the face value minus any amount of discount not yet deducted) over the purchase price is gain or income for the taxable year.

Treasury Decision 4603.

Collectors of Internal Revenue and Others Concerned:

In determining the deductions for income tax purposes of items in respect of the refunding of bonds, the following rules shall apply in the instances specified:

(a) In the case of a retirement of an issue of old bonds from the proceeds of the sale of new bonds any amount paid in excess of the face value of the old bonds, less any amount of premium received when issued and not already returned as income, and any unamortized discount and unamortized expense attributable to such bonds, is deductible in the taxable year of their retirement. However, pursuant to the discretion vested in the Commissioner, with the approval of the Secretary, by section 1163(a) of the Revenue Act of 1926, as finally amended by section 506 of the Revenue Act of 1934, in the case of such retirement of an old issue of bonds prior to the date of the approval of this Treasury decision, the tax for the year of retirement and subsequent taxable years will be determined on the basis of the ruling of the Bureau of Internal Revenue heretofore in existence to the effect that the items mentioned in the first sentence hereof should be pro-rated and amortized over the life of the new bonds, (1) if the taxable year in which the retirement occurred has been closed on that basis and the tax for such year can not be redetermined, or (2) if, where the taxable year in which such retirement occurred remains open, the taxpayer by a written communication addressed to and filed with the Commissioner of Internal Revenue, Washington, D. C., on or before January 1, 1936, gives notice of its election to have its taxes determined in accordance with such old ruling, and expressly waives in

such written communication its right to claim a refund or credit on the ground that such items are deductible in the taxable year in which the retirement occurred.

(b) In the case of a retirement of an issue of old bonds in part by exchange for new bonds and in part by payment in cash: (1) In respect of the portion of the old bonds retired with cash any amount paid in excess of the face value of the old bonds, less any amount of premium received when issued and not already returned as income, and any unamortized discount and unamortized expense attributable to such bonds, is deductible in the taxable year of their retirement, subject to the exception stated in paragraph (a) above; (2) in respect of the portion of the old bonds exchanged for new bonds such items shall be amortized over the life of the new bonds.

(c) In the case of a retirement of old bonds in exchange for new bonds of the same or a greater face value, or by the exchange for new bonds plus a bonus in cash, such items shall be amortized over the life of the new bonds.

(d) In the case of a retirement of old bonds from the proceeds of the sale or issue of capital stock such items are deductible in the year in which the old bonds are retired. In the case of a retirement of old bonds through conversion or exchange for shares of capital stock of the obligor no deduction shall be allowed on account of the unamortized balances of such items in the year the bonds are retired nor shall any amortization allowances be made in respect of such items for subsequent taxable years.

WRIGHT MATTHEWS,
Acting Commissioner of Internal Revenue.

Approved November 9, 1935.

United States Internal Revenue Regulations No. 74.

Art. 141. *Interest.*— * * * Interest paid by the taxpayer on a mortgage upon real estate of which he is the

legal or equitable owner, even though the taxpayer is not directly liable upon the bond or note secured by such mortgage, may be deducted as interest on his indebtedness. * * *

APPENDIX B.

Applicable Sections of the Act of the Commonwealth of Pennsylvania of April 29, 1874, as Amended.

(Purdon's Pennsylvania Statutes, Annotated, Title 15, Secs. 262-266, 595.)

Section 18. The capital stock or indebtedness of any corporation to be created under the provisions of this statute, or accepting its provisions, may be increased, from time to time, by the consent of the persons or bodies corporate holding the larger amount in value of the stock of such company, to such amount as such corporation is by this act authorized to increase its capital stock or indebtedness, but such increase shall only be made for money, labor done, or money or property actually received.

Section 19. Any such corporation desirous of increasing its capital stock or indebtedness as provided by this act, shall, by a resolution of its board of directors, call a meeting of its stockholders therefor, which meeting shall be held at its chief office or place of business in this commonwealth; and notice of the time, place and object of said meeting, shall be published once a week for sixty days prior to such meeting, in at least one newspaper published in the county, city or borough wherein such office or place of business is situate.

Section 20. At the meeting called, pursuant to the nineteenth section of this act, an election of the stockholders of such corporation shall be taken for or against such increase, which shall be conducted by three judges, stockholders of said corporation, appointed by the board of directors to hold said election, and if one or more of

said judges be absent, the judge or judges present shall appoint a judge or judges, who shall act in the place of the judge or judges absent, and who shall respectively take and subscribe an oath or affirmation before an officer authorized by law to administer the same, well and truly, and according to law, to conduct such election to the best of their ability; and the said judges shall decide upon the qualification of voters, and when the election is closed count the number of shares voted for and against such increase, and declare whether the persons or bodies corporate holding the larger amount of the stock of such corporation have consented to such increase, or refused to consent thereto, and shall make out duplicate returns of said election, stating the number of shares of stock that voted for such increase and the number that voted against such increase, and subscribe and deliver the same to one of the chief officers of said company.

Section 21. Each ballot shall have endorsed thereon the number of shares thereby represented, and be signed by the holder thereof, or by the person holding a proxy therefor; but no share or shares transferred within sixty days shall entitle the holder or holders thereof to vote at such election or meeting, nor shall any proxy be received, or entitle the holder to vote, unless the same shall bear date and have been executed within three months next preceding such election or meeting; and it shall be the duty of such corporation to furnish the judges at said meeting with a statement of the amount of its capital stock, with the names of persons or bodies corporate holding the same, and number of shares by each respectively held, which statement shall be signed by one of the chief officers of such corporation, with an affidavit thereto annexed that the same is true and correct to the best of his knowledge and belief.

Section 22. It shall be the duty of such corporation, if consent is given to such increase, to file in the office of the secretary of the commonwealth, within thirty days

after such election or meeting, one of the copies of the return of such election provided for by the twentieth section of this act, with a copy of the resolution and notice calling same thereto annexed; and upon the increase of the capital stock or indebtedness of such corporation made pursuant thereto, it shall be the duty of the president or treasurer of such corporation, within thirty days thereafter, to make a return to the secretary of the commonwealth, under oath, of the amount of such increase and terms of the same, that is to say, the terms on which additional stock is issued; and in case of neglect or omission so to do, the corporation shall be subject to a penalty of five thousand dollars, which penalty shall be collected on an account settled by the auditor general and state treasurer, as accounts for taxes due the commonwealth are settled and collected; and the secretary of the commonwealth shall cause said returns to be recorded in a book to be kept for that purpose, and furnish a certified copy of the same to the auditor general, and the corporation shall have the right to recover the same from the officer neglecting or omitting to file the return as aforesaid.

Section 23. Any corporation created under the provisions of this act, and any corporation of the classes named in the second section hereof, that is now in existence by virtue of any law of this Commonwealth, may reduce its capital stock or alter and change the par value or the shares thereof, by a vote of the stockholders taken in the manner and under the regulations prescribed in the eighteenth, nineteenth, twentieth, twenty-first and twenty-second sections of this act; and it shall be lawful for any corporation in the same manner to sell, assign, dispose of and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid: Provided,

That the returns required by said section shall not be filed in the office of the Secretary of the Commonwealth until each and every corporation, so selling, assigning, disposing, and conveying such franchises and property, shall have filed with the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth, setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed sale, assignment, disposition and conveyance; and that all taxes due the Commonwealth of Pennsylvania have been paid up to and including such date. * * *

APPENDIX C.

Long Form Merger Act of May 3, 1909.

(Purdon's Pennsylvania Statutes, Annotated, Title 15)

SEC. 421. *Merger authorized; exceptions; exclusive franchise not extended; merger subject to act of 1907.*

It shall be lawful for any corporation, now or hereafter organized under the provisions of any general or special act of Assembly authorizing the formation of any corporation or corporations, to merge its corporate rights, franchises, powers, and privileges with and into those of any other corporation or corporations transacting the same or a similar line of business, so that by virtue of this act such corporations may consolidate, and so that all the property, rights, franchises, and privileges then by law vested in either of such corporations, so merged, shall be transferred to and vested in the corporation in which such merger shall be made: * * *

SEC. 422. *Procedure; joint agreement; approval by stockholders; certificates; approval by governor.*

Said merger or consolidation shall be made under the conditions, provisions, and restrictions, and with the powers, herein set forth; to wit,—

First. The directors of each corporation shall enter into a joint agreement, under the corporate seal of each corporation, for the merger and consolidation of said corporations; prescribing the terms and conditions thereof, the mode of carrying the same into effect, the name of the new corporation, the number and names of the directors and other officers thereof, and who shall be the first directors and officers, and their places of residence, the number of shares of the capital stock, the amount or par value of each share, and the manner of converting the capital stock of each of said corporations into the stock of the new corporation, and how and when directors and officers shall be chosen, with such other details as they shall deem necessary to perfect the said consideration and merger; but said agreement shall not be effective unless the same shall be approved by the stockholders of said corporations in the manner hereinafter provided.

Second. Said agreement shall be submitted to the stockholders of each of said corporations, at separate special meetings or at any annual meetings, of the time, place and object of which respective meetings due notice shall be given by publication, once a week for two consecutive weeks before said respective meetings, in at least one newspaper in the county or in each of the counties in which the principal office of said respective corporations shall be situate,—excepting in the case of the merger or consolidation of corporations which, upon their original incorporation, are required by the Constitution to publish notice of intention to incorporate for a longer period than two weeks, in which case notice by publication shall be as required by the Constitution, —and at said meetings the said agreement of the directors shall be considered, and a vote of the stockholders in person or by proxy shall be taken, by ballot, for the adoption or rejection of the same, each share of stock entitling the holder thereof to one vote; and if a majority in amount of the entire capital stock of each

of said corporations shall vote in favor of said agreement, merger and consolidation, then that fact shall be certified by the secretary of each corporation, under the corporate seal thereof, and said certificates, together with the said agreement or a copy thereof, shall be filed in the office of the Secretary of the Commonwealth, who shall forthwith present the same to the Governor for his approval and when approved by the Governor the said agreement shall be deemed and taken to be the act of consolidation of said corporation.

SEC. 423. *Effect of merger; new patent; bonus; certificate of reports and payment of taxes.*

Upon the filing of said certificates and agreement, or copy of the agreement, in the office of the Secretary of the Commonwealth, and upon the issuing of new letters patent thereon by the Governor, the said merger shall be deemed to have taken place, and the said corporations to be one corporation under the name adopted in and by said agreement possessing all the rights, privileges, and franchises theretofore vested in each of them; and all the estate and property, real and personal, and rights of action, of each of said corporations, shall be deemed and taken to be transferred to and vested in the said new corporation, without any further act or deed: *Provided,* That all rights of creditors and all liens upon the property of each of said corporations shall continue unimpaired, limited in lien to the property affected by such liens at the time of the creation of the same, and the respective constituent corporations may be deemed to be in existence to preserve the same; and all debts not of record, duties, and liabilities of each of said constituent corporations shall thenceforth attach to the said new corporation, and may be enforced against it to the same extent and by the same process as if said debts, duties, and liabilities had been contracted by it. But such merger and consolidation shall not be complete, and no such consolidated corporation shall do any business of any kind, until it shall have first obtained from

the Governor of the Commonwealth new letters patent, and shall have paid to the State Treasurer a bonus, as prescribed by law, upon all its capital stock in excess of the amount of capital stock of the several corporations so consolidating, upon which the bonus required by law has been theretofore paid: *And provided further,* That new letters patent of such consolidated corporation shall not be issued by the Governor of the Commonwealth, until each corporation entering into and forming the consolidated corporation shall have filed with the Secretary of the Commonwealth a certificate from the Auditor General of the Commonwealth setting forth that all reports required by the Auditor General of the Commonwealth have been duly filed to the date of the proposed merger, and that all taxes due the Commonwealth of Pennsylvania have been paid, up to and including said date.

APPENDIX D.

Pennsylvania Corporation Laws of 1933.

Section 901. *Merger and Consolidation Authorized.* A. Any two or more domestic business corporations, or any one or more foreign business corporations, may, in the manner hereinafter provided in this article, be merged into one of such domestic business corporations, hereinafter designated as the surviving corporation, or consolidated into a new corporation to be formed under this act, provided such foreign business corporations are authorized by the law or laws of the jurisdiction under which they were formed to effect such merger or consolidation.

B. Any one or more domestic business corporations, and any one or more foreign business corporations, may, in the manner hereinafter provided in this act, be merged into one of such foreign business corporations, hereinafter designated as the surviving corporation, or consolidated into a new corporation to be formed under the law or laws of the jurisdiction under which one of the foreign

business corporations was formed, provided the laws of such jurisdiction authorize such merger or consolidation.

Section 902. *Approval of Joint Plan of Merger or Consolidation.* A. The board of directors of each of the corporations which desire to merge or consolidate shall, by resolution adopted by at least a majority vote of all the members of each board, approve a joint plan of merger or consolidation, as the case may be, setting forth the terms and conditions of the merger or consolidation and mode of carrying the same into effect, the manner and basis of converting the shares of each corporation into shares or other securities or obligations of the surviving or new corporation, as the case may be, and such other details and provisions as are deemed necessary.

B. The board of directors of each corporation, upon approving such plan of merger or plan of consolidation, shall, by resolution, direct that the plan be submitted to a vote of the shareholders of such corporation entitled to vote thereon, at an annual or special meeting of the shareholders. Written notice shall, not less than ten days before such annual or special meeting, be given to each shareholder of record of such corporation, whether or not entitled to vote on such plan, unless the plan of merger or plan of consolidation contemplates an increase in the aggregate of the authorized capital stock of the constituent corporations, in which event, sixty days' notice of such meeting shall be given to each shareholder. The notice shall state the place, day, hour and purpose of the meeting, and a copy or a summary of the plan of merger or plan of consolidation, as the case may be, shall be included in or enclosed with such notice.

C. The plan of merger or consolidation shall be approved upon receiving the affirmative vote of the holders of at least the majority of the outstanding shares entitled to vote thereon of each of the merging or consolidating corporations, unless any class of shares of any of such corporations is entitled to vote thereon as a class, in

which event, as to such corporation, the plan of merger or consolidation shall be approved upon receiving the affirmative vote of the holders of at least a majority of the outstanding shares of each class of shares entitled to vote thereon as a class, and the affirmative vote of the holders of at least a majority of all outstanding shares entitled to vote thereon.

Section 903. *Articles of Merger or Consolidation.* Upon the approval of the plan of merger or the plan of consolidation by the shareholders of the corporations desiring to merge or consolidate, articles of merger or articles of consolidation, as the case may be, shall be executed under the seal of each corporation, signed and verified by two duly authorized officers of each corporation, and shall set forth:

(1) The name and the location of the registered office of the surviving or new corporation.

(2) The time and place of the meeting of the shareholders of each corporation at which the plan of merger or consolidation, as the case may be, was adopted, the kind and period of notice given to the shareholders, and the total vote by which the plan was adopted.

(3) Any changes desired to be made in the articles of the surviving corporation in the case of a merger, or, in the case of a consolidation, all of the statements required by this act to be set forth in original articles in the case of the formation of a corporation.

(4) The number, names and addresses of the persons to be the first directors of the surviving or new corporation.

(5) The plan of merger or consolidation.

Section 904. *Advertisement.* The corporation shall advertise its intention to file articles of merger or articles of consolidation, as the case may be, with the Department of State in a manner similar to that heretofore prescribed in this act in the case of the formation of a

business corporation. Advertisements shall appear at least three days prior to the day on which the articles of merger or articles of consolidation are presented to the Department of State, and shall set forth briefly:

(1) The name and the location of the registered office of each of the corporations intending to merge or consolidate.

(2) The name and the location of the proposed registered office of the surviving or new corporation.

(3) A statement that the articles of merger or consolidation are to be filed under the provisions of this act.

(4) The purpose or purposes of the surviving or new corporation.

(5) The time when the articles of merger or consolidation will be delivered to the Department of State.

Section 905. *Filing of Articles of Merger or Consolidation.* The articles of merger or articles of consolidation, as the case may be, and proof of the advertisement required by the preceding section, shall be delivered to the Department of State. If the Department of State finds that such articles conform to law, it shall forthwith, but not prior to the day specified in the advertisement required by the preceding section, endorse its approval thereon, and when all bonus, fees, taxes and charges have been paid, as required by law, shall file the articles and issue to the corporation, or its representative, a certificate of merger or a certificate of consolidation, as the case may be, to which shall be attached a copy of the approved articles.

Section 906. *Effective Date of Merger or Consolidation.* Upon the issuance of the certificate of merger or the certificate of consolidation by the Department of State, the merger or consolidation shall be effective. The certificate of merger or the certificate of consolidation shall be conclusive evidence of the performance of all conditions precedent to such consolidation or merger

and the creation or existence of a new or surviving corporation, except as against the Commonwealth. The merger or consolidation of one or more domestic corporations into a foreign corporation shall be effective according to the provisions of law of the jurisdiction in which such foreign corporations was formed, but not until articles of merger or articles of consolidation have been adopted and filed, as heretofore provided in this act.

Section 907. *Effect of Merger or Consolidation.* Upon the merger or consolidation becoming effective, the several corporations parties to the plan of merger or consolidation shall be a single corporation which, in the case of a merger, shall be that corporation designated in the plan of merger as the surviving corporation, and, in the case of a consolidation, shall be the new corporation provided for in the plan of consolidation. The separate existence of all corporations parties to the plan of merger or consolidation shall cease, except that of the surviving corporation, in the case of a merger. The surviving or new corporation, as the case may be, shall not thereby acquire authority to engage in any business or exercise any right which a corporation may not be formed under this act to engage in or exercise. All the property, real, personal, and mixed, of each of the corporations parties to the plan of merger or consolidation, and all debts due on whatever account to any of them, including subscriptions to shares and other choses in action belonging to any of them, shall be taken and deemed to be transferred to and vested in the surviving or new corporation, as the case may be, without further act or deed. The surviving or new corporation shall thenceforth be responsible for all the liabilities and obligations of each of the corporations so merged or consolidated, but the liabilities of the merging or consolidating corporations, or of their shareholders, directors, or officers, shall not be affected, nor shall the rights of the creditors thereof or of any persons dealing with such corporations, or any liens upon the property of such corporations, be impaired by such merger or consolidation, and any claim existing or action or

proceeding pending by or against any of such corporations may be prosecuted to judgment as if such merger or consolidation had not taken place, or the surviving or new corporation may be proceeded against or substituted in its place. In the case of a merger, the articles of incorporation of the surviving corporation shall be deemed to be amended to the extent, if any, that changes in its articles are stated in the articles of merger; and in the case of a consolidation, the statements set forth in the articles of consolidation, and which are required or permitted to be set forth in the articles of incorporation of corporations formed under this act, shall be deemed to be the articles of incorporation of the new corporation. The aggregate amount of the net assets of the merging or consolidating corporations which was available for the payment of dividends immediately prior to such merger or consolidation, to the extent that the value thereof is not transferred to stated capital by the issuance of shares or otherwise, shall continue to be available for the payment of dividends by such surviving or new corporation.

APPENDIX E.

Laws of Maryland, 1890, ch. 553.

It shall be lawful for any railroad company heretofore or hereafter incorporated under the laws of this State to consolidate with any other railroad company incorporated under the laws of this or any other State, or of the United States, whose railroad within or without this State shall connect with or form a continuous line with the railroad of the company so consolidating upon such terms as may be agreed upon; provided, however, that the agreement for such consolidation shall be submitted to the stockholders of the railroad company incorporated under the laws of this State at a special meeting called for considering the same, and shall be sanctioned by the holders of a majority of the stock of such company, and if sanctioned at such meeting by such holders of a majority of the stock, shall be filed in the office of the secretary of State of this State; and, provided, further, that such

agreement shall contain no provisions in conflict with the provisions of this article or which shall exempt such railroad so far as it lies in this State from the operation of the laws of this State, and nothing in this section shall be construed to authorize the consolidation of any railroad companies owning or operating, competing or parallel roads, or parallel lines of railroad which is hereby declared to be unlawful and expressly prohibited without the special consent of the general assembly being first obtained therefor.

SUPREME COURT OF THE UNITED STATES.

Nos. 486 and 487.—October Term, 1938.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,
vs.
Metropolitan Edison Company.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner,
vs.
Pennsylvania Water & Power Company.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[April 3, 1939.]

Mr. Justice Roberts delivered the opinion of the Court.

These cases present the question whether, under the Revenue Acts of 1926 and 1928,[1] a Pennsylvania corporation may deduct unamortized bond discount and expense in connection with redemption of the bonds of a subsidiary, all of whose assets it had previously acquired pursuant to local law. The court below answered this question in the affirmative.[2] By reason of a direct conflict of decision we granted the writ of certiorari.[3]

The respondent in No. 486 is a Pennsylvania corporation supplying electric light and power in that state and also operating, through subsidiaries, a system which serves communities in Pennsylvania and Maryland. It filed consolidated returns for itself and its subsidiaries for 1927 and 1928. During 1928 the company retired certain bonds of Pennsylvania corporations which were formerly subsidiaries whose obligations the taxpayer had assumed when it took over their assets by transfers effected pursuant to an Act of

[1] Revenue Act of 1926, Sections 200(d), 212(b), 232 and 234(a)(1)(2) and (f), 44 Stat. 9, 10, 23, 41-42; Revenue Act of 1928, Sections 23(a)(b) and (f), 42, 43, 48, 45 Stat. 791, 799-800, 805, 807.

[2] 98 F. (2d) 807, 812.

[3] See General Gas & Electric Corporation v. Commissioner of Internal Revenue, 98 F. (2d) 561, in which certiorari was also granted, decided *infra* p. ——.

the General Assembly of April 29, 1874, as amended and supple mented.[4] When these obligations were redeemed there existed with respect to them, unamortized discount and expense aggre gating $752,481.26, which the company in its return deducted fro gross income. The Commissioner ruled against the deduction an determined a deficiency. The Board of Tax Appeals sustaine the Commissioner.[5] The Circuit Court of Appeals reversed th Board holding that the transactions whereby the taxpayer acquire the assets and assumed the liabilities of its former subsidiaries, pu suant to the statute, constitued a merger, as a consequence of whic the subsidiaries ceased to exist by operation of law whereas th taxpayer continued to exist and became liable for the subsidiaries debts both under contract and by operation of law. The cour therefore, held that the unamortized discount and expense was de ductible in respect of the subsidiary's bonds.

In 1923 the respondent in No. 486 desired to erect a generatin plant for electric energy. Wishing to finance it by a separate bon issue the respondent organized Metropolitan Power Company, Pennsylvania corporation, as a wholly owned subsidiary. The tax payer purchased, guaranteed, and sold, at the same price it ha purchased, $3,250,000 of bonds of the subsidiary; purchased all o its stock and loaned it on open account approximately $3,000,00 The Power Company held no public franchises and, under a co tract with the taxpayer, sold all of its electricity to the latter at price sufficient to enable it merely to earn the costs of operatio and other charges, including depreciation, taxes, and interest. I 1927, pursuant to State authority, the Power Company sold all i assets subject to its liabilities to the taxpayer, a deficit from oper tions being charged against the taxpayer's surplus. At the tim of the transfer the taxpayer surrendered the stock of the Pow Company for cancellation and the latter became inactive and w dissolved in 1928. The taxpayer assumed liability for the outstan ing bonds of the Power Company payment of which it had original guaranteed and, during 1927, called them for redemption and r deemed them. At the time of the redemption there remained u amortized discount and expense incurred in issuing the bonds a

[4] Act of April 29, 1874, P. L. 73, Sec. 23, amended by Act of April 17, 187 P. L. 30, Sec. 5, and Act of June 2, 1915, P. L. 724, Sec. 1. Purdon's P Stats. Tit. 15, Sec. 595.

[5] 35 B. T. A. 1110.

gregating $308,097.90 which the taxpayer deducted from its gross income. The Commissioner ruled against the deduction and the Board of Tax Appeals sustained him.[6] The Court of Appeals reversed the Board, holding that, while the transaction was not consummated under the state statute it nevertheless was under state law a *de facto* merger and, the taxpayer was accordingly entitled to the deduction.

The respondent in No. 487 is a Pennsylvania corporation operating a hydro electric plant at Holtwood, Pennsylvania. In 1924 it desired to provide its customers with a more adequate supply by an auxiliary steam power plant. As its corporate powers did not permit steam generation of electricity it caused the incorporation of a Pennsylvania company, known as Holtwood Power Company, all of whose shares were purchased and owned by the respondent. With the proceeds of the sale of the Power Company's stock and those of a bond issue the steam plant was erected. This plant sold all its output to the taxpayer which agreed, in return, to pay the Power Company's costs and expenses and an allowance for depreciation, and to pay a sum to provide for amortization of debt, discount, and security issue expense, and the expenses attending the issue, registration and transfer of the capital stock and bonds, all interest on bonds and other indebtedness, and a sum sufficient to provide a net return of eight per cent. on the Power Company's stock. The steam plant was managed by the taxpayer's officers and employes without compensation and was operated as a department of the taxpayer. In 1927 the taxpayer surrendered certain corporate powers so as to be in a position to effect a merger or consolidation with its subsidiary under the Pennsylvania statutes.[7] Thereupon the Power Company conveyed all of its assets and franchises to the taxpayer pursuant to the Pennsylvania Act of 1874 as amended, the sole consideration being the delivery to the subsidiary of all its capital stock held by the taxpayer and the assumption by the taxpayer of the subsidiary's indebtedness. The subsidiary ceased to exist. In 1928 the taxpayer retired the bonds of its former subsidiary and charged off unamortized discount and expense in respect of them in the sum of $145,159.52 and, in its income tax return for that year, claimed a small deduction for

[6] 33 B. T. A. 1110.

[7] See York Haven Water & Power Co. v. Public Service Commission, 287 Pa. 241, 249; 134 Atl. 419, 421.

amortization for a portion of the year prior to the retirement, and a deduction of the balance of the sum above mentioned as of the date when the retirement took place. The Commissioner disallowed the deduction and determined a deficiency. The Board of Tax Appeals sustained the ruling.[8] The Circuit Court of Appeals reversed the Board.

The petitioner concedes that if there has been a true merger or consolidation whereby the identity of the corporation issuing the bonds continues in the successor and the latter becomes liable for the debts of the former by operation of law, the successor may deduct amortization of discount and expense in respect of bonds issued by its predecessor as well as unamortized discount and expense on any of such bonds retired prior to maturity.[9] The rule is not applicable upon a mere sale by one corporation of all its assets to another which assumes the liabilities of the former.[10]

The contention of the petitioner is that the transactions in issue fall within the latter category. The respondents, on the other hand, insist that, in the light of the applicable statute of Pennsylvania and the decisions of her courts, the transactions constituted mergers in the proper acceptation of that term. The question, then, is solely one respecting the law of Pennsylvania.

Until the complete revision of the corporation laws of the Commonwealth in 1933 there were but two statutes available to corporations seeking to merge or consolidate. The Act of April 29, 1874, Sec. 23, *supra*, so far as material, provides that any corporation, with the consent of its stockholders, may "sell, assign, dispose of and convey to any corporation created under or accepting the provisions of this act, its franchises, and all its property, real, personal and mixed, and thereafter such corporation shall cease to exist, and the said property and franchises not inconsistent with this act, shall thereafter be vested in the corporation so purchasing as aforesaid. . . ." The Act of May 3, 1909,[11] permits what

[8] 36 B. T. A. 467.

[9] American Gas & Electric Co. v. Commissioner, 85 F. (2d) 327; American Gas & Electric Co. v. United States, 17 F. Supp. 151; New York Cent. R. Co. v. Commissioner, 79 F. (2d) 247; Western Maryland Ry. Co. v. Commissioner, 33 F. (2d) 695; Illinois Power & Light Corp. v. Commissioner, 33 B. T. A. 1189; Connecticut Electric Service Co. v. Commissioner, 35 B. T. A. 444.

[10] Turner-Farber-Love Co. v. Helvering, 68 F. (2d) 416; American Gas & Electric Co. v. Commissioner, *supra*; American Gas & Electric Co. v. United States, *supra*.

[11] Purdon's Pa. Stats. Tit. 15, Sec. 421, etc.

terms a merger but what is in truth a consolidation to be effected by a joint agreement of two or more corporations approved by the stockholders setting forth the terms and conditions of the merger and consolidation and providing for the organization of a new corporation to which the franchises and property of the consolidating corporations are to be transferred. This act contemplates the issue of letters patent to the consolidated corporation, and the issue of new stock by it, in lieu of that of the old. The procedure under the Act of 1874 has repeatedly been referred to in the decisions of the Supreme Court of the Commonwealth as the "short form" and that under the Act of 1909 as the "long form" of merger.[12]

Inasmuch as the transfer of the franchises and assets is authorized by statute, it seems reasonably clear that the transferee is, as matter of law, liable for the obligation of the transferor. The cases indicate that this is so.[13] The petitioner argues and the Circuit Court of Appeals for the Second Circuit has held to the contrary, in reliance on *Merwine* v. *Mt. Pocono Light & Imp. Co.*, 304 Pa. 517, 156 Atl. 150. That court thought the case indicated that the liability, if any, of the transferee was not under the statute but was only that of a fraudulent transferee under 13 Eliz., chap. 5. Action for a tort had been brought against the transferor prior to a transfer under the Act of 1874. After the conveyance the defendant filed a suggestion that the property had been conveyed in proceedings under the Act, that the defendant had ceased to exist, and that the action should be abated. The plaintiff sought to substitute the transferee as defendant. The trial court denied substitution and abated the action. The Supreme Court held that the termination of corporate existence of the defendant under the Act of 1874 did not abate the action, but that if the plaintiff recovered a judgment she could "levy wherever defendant's assets liable for the judgment may be found", which seems to us to mean no more than that the assets after the conveyance remained subject to the transferor's liabilities. A transfer fully authorized by statute cannot be a fraudulent conveyance within the 13 Eliz.

We are of opinion that a transfer without valuable consideration, with the intent that the transferor shall, as the statute provides,

[12] See York Haven Water & Power Co. v. Public Service Commission, 287 Pa. 241, 246, 134 Atl. 419, 420; Buist's Estate, 297 Pa. 537, 541, 147 Atl. 606, 607; compare Stockley Penna. Corp. Laws 1933, pp. 39, 104; Penna. Utilities Co. v. Public Service Commission, 69 Pa. Super. Ct. 612.

[13] Berkovitz's Appeal, 319 Pa. 397, 407, 179 Atl. 746 at 751; Commonwealth v. Merchants National Bank, 323 Pa. 145, 155, 185 Atl. 823, 827.

cease to exist, made in accordance with the statute, has all the elements of a merger and comes within the principle that the corporate personality of the transferor is drowned in that of the transferee. It results that the continuing corporation may deduct unamortized bond discount and expense in respect of the obligations of the transferring affiliate.

A somewhat different question arises with respect to the transfer of assets of Metropolitan Power Company. It is admitted that this transfer was not made in accordance with the terms of the Act of 1874. No franchises were transferred because the Metropolitan Power Company held no public franchises of any kind. The transfer was merely of assets with the assumption of all the liabilities by the transferee. It is important to note, however, that amongst the liabilities assumed were bonds on which the parent company was already liable as guarantor. The court below has held, and we concur, that, under the law of Pennsylvania, the transfer in question constituted a *de facto* merger, even though the transfer did not comply with all the provisions of the Act of 1874,[14] and that, as matter of law, the taxpayer would be liable for the debts of the transferor.

Judgments affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

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[14] Commonwealth v. Merchants National Bank, *supra*, p. 152.